INTERSTATE SALES TAX COLLECTION ACT OF 1987

HEARING

BEFORE THE

SUBCOMMITTEE ON
SELECT REVENUE MEASURES

OF THE

COMMITTEE ON WAYS AND MEANS
HOUSE OF REPRESENTATIVES

ONE HUNDREDTH CONGRESS

FIRST SESSION

ON

H.R. 1242

INTERSTATE SALES TAX COLLECTION ACT OF 1987

MAY 13, 1987

Serial 100–30

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THE INTERSTATE SALES TAX COLLECTION ACT OF 1987

WEDNESDAY, MAY 13, 1987

HOUSE OF REPRESENTATIVES,
COMMITTEE ON WAYS AND MEANS,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
Washington, DC.

The subcommittee met, pursuant to notice, at 10:10 a.m., in room 1100, Longworth House Office Building, Hon. Charles B. Rangel (chairman of the subcommittee) presiding.

[The press release announcing the hearing and H.R. 1242, follow:]

FOR IMMEDIATE RELEASE
TUESDAY, APRIL 28, 1987

PRESS RELEASE #3
SUBCOMMITTEE ON SELECT REVENUE MEASURES
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
1102 LONGWORTH BUILDING
WASHINGTON, D.C. 20515
TELEPHONE: (202) 225-3627

THE HONORABLE CHARLES B. RANGEL (D., N.Y.), CHAIRMAN,
SUBCOMMITTEE ON SELECT REVENUE MEASURES,
COMMITTEE ON WAYS AND MEANS, U. S. HOUSE OF REPRESENTATIVES,
ANNOUNCES A PUBLIC HEARING ON H.R. 1242,
THE INTERSTATE SALES TAX COLLECTION ACT OF 1987

The Honorable Charles B. Rangel (D., N.Y.), Chairman, Subcommittee on Select Revenue Measures, Committee on Ways and Means, U.S. House of Representatives, announced today that the Subcommittee will hold a public hearing on H.R. 1242, the Interstate Sales Tax Collection Act of 1987, introduced by Congressman Byron L. Dorgan (D., N.D.), a member of the Subcommittee and consponsored by Congressmen Sander Levin and Hal Daub, members of the Committee, and others. The hearing will be held on Wednesday, May 13, 1987, at 10:00 a.m. in room 1100 in the Longworth House Office Building.

H.R. 1242 would authorize States or local governments to require retailers to collect sales and use taxes on interstate sales and would amend the Internal Revenue Code of 1986 to require such retailers to file information returns with the Internal Revenue Service for the purpose of assisting States in the collection of such taxes.

Under current law, a State or local government may constitutionally impose taxes on sales that occur within its jurisdiction or on the use of property within its jurisdiction. The sales tax authority of a State or local government extends to mail order sales by out-of state vendors to residents of the State if the sale is deemed to take place within the taxing jurisdiction. There are, however, limitations on the methods which State and local jurisdictions may employ to collect sales and use taxes.

State and local sales and use taxes are levied on the final purchaser, but are collected primarily through the vendor. In the case of a sale by an out-of-state vendor, the U.S. Supreme Court has held in National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967), that the State or local government cannot constitutionally require the vendor to collect and remit use taxes unless the vendor has a sufficient business nexus with the State. In that case, the Court found that the required nexus was not present where the vendor's only connection with customers in the State was by common carriers or the United States mail. The Court based this conclusion on due process considerations and on the Commerce Clause of the United States Constitution, which reserves to Congress the power to regulate and control interstate commerce. The required nexus has been held to exist where the vendor arranges sales through local agents or maintains retail stores in the taxing State.

The Treasury Department is expected to be the first witness. Public testimony is invited on H.R. 1242.

DETAILS FOR SUBMISSION OF REQUESTS TO BE HEARD:

Individuals and organizations interested in presenting oral testimony before the Subcommittee must submit their requests to be heard by telephone to Harriett Lawler [(202) 225-3627] no later than Tuesday, May 5, 1987, to be followed by a formal written request to Joseph K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. The Subcommittee staff will notify by telephone those scheduled to appear as soon as possible after the filing deadline. Any questions concerning a scheduled appearance should be directed to the Subcommittee [(202) 225-9710].

It is urged that persons and organizations having a common position make every effort to designate one spokesperson to represent them in order for the Subcommittee to hear as many points of view as possible. Time for oral presentations will be strictly limited with the understanding that a more detailed statement may be included in the printed record of the hearing. This process will afford more time for members to question witnesses. In addition, witnesses may be grouped as panelists with strict time limitations for each panelist.

In order to assure the most productive use of the limited amount of time available to question hearing witnesses, all witnesses scheduled to appear before the Subcommittee are required to submit 100 copies of their prepared statements to the Subcommittee office, room 1111 Longworth House Office Building, at least 24 hours in advance of their scheduled appearance. Failure to comply with this requirement may result in the witness being denied the opportunity to testify in person.

WRITTEN STATEMENTS IN LIEU OF PERSONAL APPEARANCE:

Persons submitting written statements for the printed record of the hearing should submit at least six (6) copies by the close of business, Wednesday, May 27, 1987, to Jospeh K. Dowley, Chief Counsel, Committee on Ways and Means, U.S. House of Representatives, 1102 Longworth House Office Building, Washington, D.C. 20515. If those filing written statements for the record of the printed hearing wish to have their statements distributed to the press and the interested public, they may provide 100 additional copies for this purpose to the Subcommittee office, room 1111 Longworth House Office Building, before the hearing begins.

SEE ENCLOSED FORMATTING REQUIREMENTS

* * * * * * * * * *

I

100TH CONGRESS
1ST SESSION

H. R. 1242

To require retailers to collect sales and use taxes on interstate sales and to amend the Internal Revenue Code of 1986 to require such retailers to file information returns with the Internal Revenue Service for the purpose of assisting States in the collection of such taxes.

IN THE HOUSE OF REPRESENTATIVES

FEBRUARY 25, 1987

Mr. DORGAN of North Dakota introduced the following bill; which was referred jointly to the Committees on the Judiciary and Ways and Means

MAY 12, 1987

Additional sponsors: Mr. PENNY, Mr. MONTGOMERY, Mr. LEVIN of Michigan, Mr. DAUB, Mr. HAYES of Illinois, and Mr. STARK

A BILL

To require retailers to collect sales and use taxes on interstate sales and to amend the Internal Revenue Code of 1986 to require such retailers to file information returns with the Internal Revenue Service for the purpose of assisting States in the collection of such taxes.

Be it enacted by the Senate and House of Representatives of the United States of America in Congress assembled,

SECTION 1. SHORT TITLE.

This Act may be cited as the "Interstate Sales Tax Collection Act of 1987".

SEC. 2. STATES, ETC. AUTHORIZED TO REQUIRE CERTAIN RETAILERS TO COLLECT SALES AND USE TAXES.

(a) Any State, or political subdivision thereof, shall have the power to require a retailer engaged in business in that State to collect a State and local sales or use tax on the sale or use of tangible personal property shipped or delivered into that State and political subdivision.

(b) For purposes of this section, "Retailer engaged in business in that State" shall include any of the following:

(1) As respects a lease, any retailer deriving rentals from a lease of tangible personal property situated in that State.

(2) Any retailer soliciting orders for tangible personal property by means of advertising which is broadcast from, printed at, or distributed from, a location in that State if the advertising is intended to be disseminated to consumers located in that State and is only secondarily disseminated to bordering jurisdictions.

(3) Any retailer soliciting orders for tangible personal property by mail if the solicitations are substantial and recurring and if the retailer benefits from any banking, financing, debt collection, telecommunications, or marketing activities occurring in that State or benefits from the location in that State of authorized installation, servicing, or repair facilities.

(4) Any retailer owned or controlled by the same interests which own or control any retailer engaged in business in the same or a similar line of business in that State.

(5) Any retailer having a franchisee or licensee operating under its trade name if the franchisee or licensee is required to collect the tax under this section.

A person shall be treated as a retailer for purposes of this section if such person would be so treated under the sales and use tax laws of the State with respect to which the determination under the preceding sentence is being made.

(c) A State, or political subdivision thereof, shall not have the power to require a retailer engaged in business in that State to collect a state and local sales or use tax unless the combined rate of tax is imposed at the same rate on the same transactions in all geographic areas of the State.

(d) All such local taxes are to be collected and administered by the State.

(e) No retailer required to collect state and local sales and use taxes solely by reason of this section shall be required to geographically account for such taxes.

(f) A State, or political subdivision thereof, shall not have the power to require a retailer engaged in business in that State to collect a State and local sales or use tax unless such retailer's annual nationwide gross sales of tangible per-

sonal property exceeds $5,000,000. For purposes of the preceding sentence, a retailer's annual nationwide gross sales shall include the annual nationwide gross sales of tangible personal property of all predecessors of such retailer and of all persons who are described in paragraph (4) or (5) of subsection (b) with respect to such retailer.

(g) Nothing in this section shall be construed to limit a State's or political subdivision's authority to impose a requirement to collect a sales or use tax upon any retailer if that retailer is or may be required to collect such sales or use tax without regard to this section.

SEC. 3. INFORMATION RETURNS REQUIRED WITH RESPECT TO CERTAIN INTERSTATE SALES.

(a) IN GENERAL.—Subpart B of part III of subchapter A of chapter 61 of the Internal Revenue Code of 1986 (relating to information concerning transactions with other persons) is amended by adding at the end thereof the following new section:

"SEC. 6050O. RETURNS RELATING TO CERTAIN INTERSTATE SALES OF TANGIBLE PERSONAL PROPERTY.

"(a) GENERAL RULE.—Each interstate retailer to which this section applies shall make a return containing the information required by subsection (c).

"(b) RETAILERS TO WHICH SECTION APPLIES.—This section shall apply to any person which, at any time during

the period covered by the return under subsection (a), was a retailer to which section 2 of the Interstate Sales Tax Collection Act of 1987 applies.

"(c) INFORMATION REQUIRED.—

"(1) IN GENERAL.—The information required to be shown by a retailer on the return under subsection (a) is—

"(A) such retailer's annual nationwide gross sales of tangible personal property,

"(B) the annual nationwide gross sales of tangible personal property of all predecessors of such retailer and of all persons who are described in paragraph (4) or (5) of section 2(b) of the Interstate Sales Tax Collection Act of 1987 with respect to such retailer,

"(C) with respect to each State, the sales and uses (and the gross receipts with respect thereto) of tangible personal property shipped or delivered into such State by or on behalf of such retailer during the period covered by the return, and

"(D) such other information as the Secretary may prescribe.

"(2) EXCEPTION FOR CERTAIN SALES.—Subparagraph (C) of paragraph (1) shall apply only to sales

with respect to which State and local sales and use taxes are required to be collected solely by reason of section 2 of the Interstate Sales Tax Collection Act of 1987.

"(d) FORM AND PERIOD COVERED BY RETURN.—The return required under subsection (a) shall be made—

"(1) in such form, and

"(2) at such times (but not less often than annually),

as the Secretary may prescribe.

"(e) AVAILABILITY OF RETURN TO STATES.—

"For availability of returns to States in administration of State tax laws, see section 6103(d)."

(b) DISCLOSURE OF RETURN INFORMATION TO STATES.—Paragraph (1) of section 6103(d) of such Code (relating to disclosure to State tax officials) is amended by adding at the end thereof the following new sentence: "For purposes of this paragraph, the term 'State tax laws' includes laws relating to sales and use taxes required to be collected by a retailer pursuant to section 2 of the Interstate Sales Tax Collection Act of 1987."

(c) PENALTY FOR FAILURE TO FILE RETURN.—Subparagraph (B) of section 6724(d)(1) of such Code (defining information return) is amended by redesignating clauses (ix) and (x) as clauses (x) and (xi), respectively, and by inserting after clause (viii) the following new clause:

"(ix) section 6050O(a) (relating to returns relating to certain interstate sales of tangible personal property),".

(d) CLERICAL AMENDMENT.—The table of sections for subpart B of part III of subchapter A of chapter 61 of such Code is amended by adding at the end thereof the following new item:

"Sec. 6050O. Returns relating to certain interstate sales of tangible personal property."

Chairman RANGEL. The subcommittee will come to order. Mr. Dorgan?

Mr. DORGAN. Thank you, Mr. Chairman. Let me thank the chairman of the full committee and the chairman of the subcommittee for holding hearings on this legislation. Let me just briefly describe what I see as the problem and why I believe there needs to be a solution offered to the problem from the U.S. Congress.

I think we have a problem in this country, because of the *National Bellas Hess* case that puts Main Street merchants at a disadvantage.

When Main Street merchants all across the country, in States that do have a sales tax, sell tangible property they must collect the sales tax.

But, if a competitor of that Main Street merchant living 2,000 miles away sells in that State by a mail order catalog or by direct television solicitation, he does not have to collect the sales or use tax. For that reason, the Main Street merchant is at a competitive disadvantage.

The Main Street merchant pays the rent or buys the building, hires the employee, puts the inventory on the floor. They do have to collect the tax. Someone competing with them does not. I think it is patently unfair.

Second, about a billion and a half dollars a year, according to the top end of the estimates, is lost by State governments; $10 million a year in my home State of North Dakota is lost because we do not have jurisdiction to tax that activity.

The bill I introduced would simply say that if you are prepared to do business in the State, you need to be prepared to comply with the same tax laws as the instate business person.

It is a very simple piece of legislation. To be sure, it is controversial. I understand that if I were running a mail order company out of Chicago or New York or somewhere, I would not necessarily want to have to comply with all the states or use tax laws.

But, frankly, the absence of complying with them is unfair to Main Street business people in Illinois, in New York, in North Dakota and I think we need to make the changes necessary that I have described in this bill.

The bill offers fair competition. It provides a State the revenue it should be getting in the first instance. It is the right thing to do.

Mr. Chairman, I recognize that there is some controversy. I want to listen with an open mind. We want legislation, if passed, to be legislation that represents all of the best suggestions that are available from supporters and opponents and that is the spirit within which I offer this legislation and the spirit within which I hope we have this hearing today.

And I would like to offer a statement for the record, Mr. Chairman.

Chairman RANGEL. Without objection, your statement will be placed into the record.

[The statement of Mr. Dorgan follows:]

Byron L. Dorgan

Statement by the Honorable Byron L. Dorgan
Subcommittee on Select Revenue Measures
May 13, 1987

At a time when our States have been confronted by severe cuts in Federal assistance and are searching for funds to support necessary programs and services, they are losing $1.5 billion in annual sales tax revenues.

Main street businesses in states with a sales tax must collect those sales taxes and remit the revenue to the states. But, states are limited in their ability to collect taxes from out-of-state firms.

As a result of a Supreme Court decision in 1967, National Bellas Hess, the states were put at a distinct disadvantage in trying to collect legally-owed taxes. The Supreme Court, in a 6-3 decision, siad that a state could not require a company to collect sales taxes if its only "nexus", that is, business connection in the state, was through the mail or other kinds of delivery service.

So, while mail order and direct marketers can solicit business in a state and profit by it, they do not have to collect the state sales tax due on those sales as do retailers in the state. In my opinion, this represents a basic inequity. In essence, the out-of-state firms have a price advantage over in-state businesses, because thay do not charge sales taxes which can range as high as seven percent.

We are hear today to consider legislation which will help the states collect these lost sales taxes. I believe that Congress has not only the authority, but the obligation, to respond to a situation which is only getting worse. The tax base for states is eroding and the states are restricted by Bellas Hess to change this pattern. The federal government can and should step in to aid the states in this instance.

The problem, as I stated, is getting worse. When Bellas Hess was decided in 1967, the mail order market looked very different and was relatively small. Today, we have witnessed an explosion in mail order, direct marketing, 800 telephone numbers, cable television homes sales, and other electronic methods of sales. These sales are increasing and represent about 14% of all retail sales now. At the same time sales are increasing, states are losing more and more revenue and in-state retailers are confronting unfair competition.

H.R. 1242 addresses these issues in a fair and efficient way. The bill defines nexus and requires the retailer to collect sales taxes and remit them to the consumer's state. This bill is sensitive to the compliance question. For example, the state must have a uniform tax in order for the legislation to apply. Moreover, this bill exempts firms with sales under $5 million. That means that 96% of the firms will not have to comply. My bill aims at the large firms which represent about 76% of all sales. Finally, the bill requires that retailers provide information reports to the Internal Revenue States in order to assist the states in calculating and collecting the sales taxes. Thus, my legislation takes a fair and responsible approach to this problem.

This issue boils down to two things: fairness and dollars and cents. In-state retailers should not be placed at a competitive disadvantage with out-of-state firms. States should not have to lose $1.5 billion in taxes which could easily be collected by out-of-state retailers.

I welcome this opportunity to discuss this issue and perfect this legislation. Congress should not wait any longer in addressing this issue.

Chairman RANGEL. Mr. McGrath.

Mr. MCGRATH. Thank you, Mr. Chairman and I want to thank you for holding this hearing on this subject on sales tax of mail order sales. And I commend my colleague, Mr. Dorgan, who is a former State tax collector, so I guess he knows something about this, in bringing this bill before our committee.

I would also like to point out, Mr. Chairman, that one of the witnesses today, is the State tax commissioner from our State, Roderick Chu, who has done an outstanding job as tax commissioner in New York State and we are looking forward to the testimony, not only of the Treasury, but of the, certainly, fine panels that we have put together. Thank you, Mr. Chairman.

Chairman RANGEL. Mr. Andrews?

Mr. ANDREWS. Thank you, Mr. Chairman. I look forward to the testimony we are going to hear today as well. This is a serious issue and it is certainly one that is serious for Texas.

Congressman Jack Brooks has introduced similar legislation and I wonder, Mr. Chairman, if I might, in my opening statement, inquire of Mr. Dorgan if he could briefly enumerate the differences between the Dorgan bill and the bill that Jack Brooks has introduced.

Mr. DORGAN. I would be happy to respond to that. There are several differences in the legislation, one dealing with the way "nexus" is defined and another dealing with reporting requirements that I have in my legislation.

But let me be quick to point out that I visited with Congressman Brooks yesterday on this subject. I do not think the differences are very significant to either of us. It is my intention, and that of Mr. Brooks, to get together at some point in the near future and merge these two bills.

We have the same interests. We want to solve the same problem. Even though we have different pieces of legislation now, it is our intention to bring them together in one piece of legislation and move forward together.

Mr. ANDREWS. This is a serious issue; $1.5 billion may be lost annually in uncollected sales tax. That is the estimate for 1985. And, Mr. Chairman, I appreciate the opportunity to have this hearing and look forward to the testimony.

Chairman RANGEL. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman. I have no opening statement.

STATEMENT OF O. DONALDSON CHAPOTON, DEPUTY ASSISTANT SECRETARY (TAX POLICY), U.S. DEPARTMENT OF THE TREASURY

Chairman RANGEL. The Deputy Assistant Secretary of the Treasury on Tax Policy, Mr. Chapoton, we thank you for being with us to share the administration's views on this serious subject. Thank you.

Mr. CHAPOTON. Thank you, Mr. Chairman.

Chairman RANGEL. Your full statement will appear in the record, without objection, and you may proceed as you feel most comfortable.

Mr. CHAPOTON. I will submit the full statement for the record and I would like to simply make some comments about the subject

matter of this bill and then I will be happy to answer any questions.

Let me start out by giving a brief background statement about sales taxes. State sales taxes are generally single rate, ad valorem taxes imposed on a broad range of personal property, sold at retail throughout a State.

Forty-five of the fifty States and the District of Columbia have sales taxes and these sales taxes range from a low of 2 percent to a high of 7½ or 8 percent.

In addition to State sales taxes, approximately 6,000 different local governments impose sales taxes. Sales and use taxes on the average account for over 30 percent of State tax revenues.

In addition to the differences in the tax rate and the tax base, the legal form of the sales tax varies from State to State. Most sales taxes are imposed upon the consumer, the purchaser, but are, in fact, collected at the retail level.

In some States the sales taxes are actually imposed on the retailer and are levied in the form of an occupation or a privilege tax. The form of this tax is significant only from the legal standpoint of who bears liability for payment, but the concept and the incidence of the tax are still the same. It is a tax on sales by retailers to consumers.

All States that have a sales tax also have a use tax, which is designed to tax consumer purchases in the state which are not subject to the sales tax. The use tax is imposed in most cases only if the sales tax does not already apply to the goods or the products which have been sold to the consumer.

The main questions which are raised for consideration today relate to interstate retail sales to consumers and the problems that the States have in collecting sales taxes on such interstate sales. This squarely raises some constitutional questions which have been addressed in a number of Supreme Court decisions, the most significant of which is the *National Bellas Hess* case decided by the U.S. Supreme Court in 1967. Under the decisions prior to *National Bellas Hess* it was well settled that if a vendor maintains a place of business within a taxing State, the State may require that the vendor collect the taxing State's sales or use tax with respect to mail order sales to residents of the taxing State, even if the place of business that the vendor maintains in the State has little or nothing to do with the mail order sale which is sought to be taxed by the State. There is no constitutional limitation in that regard so long as the vendor maintains a fixed place of business in the State. If the vendor solicits customers through agents or independent contractors located in the taxing State, that, too, has been held by the Supreme Court to permit the State to enforce its sales or use tax on interstate sales.

However, in the *National Bellas Hess* case, the Supreme Court struck down an Illinois taxing provision which would have imposed the State's sales tax where the sole contact of the vendor with Illinois was by advertising in the State through mail catalogs and circulars and by the delivery of the ordered products by common carrier. The Supreme Court held that there was simply an insufficient nexus with the taxing State and that, therefore, the imposition by Illinois on the out-of-State retailer of the requirement to collect Illinois use tax was an unreasonable and unconstitutional burden on interstate commerce.

Mr. McGRATH. Will the gentleman yield on that point? I just want to get it clear in my mind. As I understand your explanation of that particular case, that particular State had no sales tax?

Mr. CHAPOTON. No, I believe it had both a sales and a use tax.

Mr. McGRATH. All of the other court cases provided that they must collect sales tax if they had a sales tax within that particular State.

Now, in the interstate case, if the State had no sales tax—let's say a company was residing in a State that had no sales tax—are they, by virtue of this decision, then exempted from collecting sales taxes from other States? Is that what you are trying to say?

Mr. CHAPOTON. I think it would matter if the selling State did or did not have a sales tax. What matters is where the consumer resides and whether that State attempts to impose a sales or a use tax on that consumer. If so, the taxing State may collect it from the retailer located in another State.

Mr. DORGAN. My understanding of the case was that it was found as a result of the commerce clause, that in order for the State to have nexus to require the seller to collect the State sales or use tax, the Federal Government would have to provide that description of nexus, that the States doing that individually interfered with the commerce clause.

That is why, in this case, we can, in effect, overturn what had been a Supreme Court decision on the matter.

Mr. CHAPOTON. I would like to touch on that in a minute, you are correct that the decision was under the commerce clause, but it also described the due process clause of the Constitution which we have to deal with.

Let me touch briefly on what the legislation does. H.R. 1242 attempts to establish that minimum business nexus that is required of the retailer for him to be required to cooperate with the purchasing State to collect and enforce that State's tax. The nexus would be found if one of three types of activities, as I understand it, Mr. Dorgan, are available. One nexus condition is if the seller derives rentals from leased property located in the State. Second, if the retailer advertises in the purchasing State by broadcasting, printing or distributing items within that State. And, finally, if the retailer benefits from any banking or debt collection or marketing activities conducted in the State where the purchasing occurs. There are, in addition, other provisions dealing with related parties who are subject to the nexus rules. A retailer can be subject to the nexus rules and, therefore, be subject to the collection of a State's tax, even if the retailer is not, itself, engaged in business in the other State, but has a related party which is so engaged.

In addition, H.R. 1242 imposes requirements on the IRS to assist in the collection of sales taxes by imposing information reporting requirements on all retailers who meet certain requirements. These information reports must be filed with the Internal Revenue Service, just like a regular tax return. They are information returns and in themselves contain no tax liability requirements. The returns could be subject to information return penalties if they are not, in fact, filed.

With that background, let me say that we have studied this bill and we have studied this area of the law and we think it is a com-

plex and very serious issue to the States. We know that State sales and use taxes are an important source of revenue to State and local governments. We know that there is an understandable concern on the part of these State and local governments that these taxes are being avoided by the purchase of goods from out of State vendors. And, further, we know that the collection of the use tax from individual consumers is impractical, except where there can be independent verification of the sales and of information concerning the sales. Thus, the taxing States must, of necessity, rely on out of State vendors to collect their sales and use taxes with respect to such sales.

But as we have just discussed, there are constitutional limits on what the States can do in this regard and particularly the limitations of the commerce clause that we discussed.

This bill is intended to curb the loss of State revenue and it does so by involving the Federal Government in collection of the State sales and use taxes in two completely different ways.

First, it sets Federal standards for satisfaction of the nexus requirements, that is, the three primary requirements, which I have touched on. Also, the bill would impose some Federal limitations on the collection of this tax. Specifically, the bill would include a $5 million de minimis rule so that retailers who sold less than $5 million per year would not be subject to the collection requirements authorized under the bill. The bill also would apply only if the States sales and use taxes were imposed at a single rate and without regard to multiple rates charged by the various individual jurisdictions within the State. Finally the bill limits any geographical reporting or accounting that may be required by the various States.

While we are very sympathetic with the concerns of the States, we have our own concern about the bill. First, although the bill prescribes the minimum business nexus, it does not, thereby automatically resolve the constitutional questions. As we pointed out, Mr. Dorgan, the commerce clause was the issue primarily raised in the *National Bellas Hess* case. The *Bellas Hess* case, however, did touch on the due process clause as well. While the Federal Government certainly has authority to step in and legislate under the commerce clause to expand the ability of the States to collect taxes, we are not entirely sure that it has that authority to expand the due process provisions of the Constitution.

The *National Bellas Hess* case, in regard to the due process clause, provided that the basic test is whether the taxing State which seeks to impose the tax has, in fact, benefited the retailer sufficiently to allow it to collect the tax from the retailer. If it has not, the implication is that there is a constitutional prohibition against collecting the tax, either under the commerce clause, where limitations might be altered by Federal legislation, or under the due process clause where requirements might not be subject to being altered under Federal legislation.

I do not mean to suggest that we are expressing an opinion on the constitutionality of this provision. On the contrary, we think this area of the law is not easily discernable as to the constitutional limitations. But we do mean to suggest that this bill would not necessarily resolve the unsettled constitutional issues and, there-

fore, some additional attention might have to be given to them even if the bill is passed.

We would note that there are further uncertainties under the bill which give us some concern. First, the bill does not specifically overturn *National Bellas Hess* in regards to the nexus requirements. The bill does not provide that if the factual situation were such that existed in *Bellas Hess* that that would be a permissible nexus.

Furthermore, it raises the possibility of requiring investment with the taxing State's through debt collection, banking or marketing activities and we are not entirely sure what that means. Whether the bill would require the use of instate banking, credit facilities or communications between retailers and customers to establish the minimum nexus is not clear. There is no definitive Supreme Court resolution of whether such contacts are sufficient, in the absence of Federal legislation. The dissent, in the *National Bellas Hess* case, commented on the fact that the credit facilities in the taxing State were used and the dissent argued that under the Constitution, without any Federal statute, that that should be sufficient for establishing nexus. However, the majority opinion held otherwise.

In this connection, I would note that we certainly agree that there are circumstances in which the Congress should exercise its authority to preserve the Federal interest in the State and local tax area, particularly in the realm of interstate commerce and international commerce. Where the Federal Government has a strong interest in insuring that State taxing authorities do not unduly interfere with international commercial interests, it must act. Therefore, we are not saying it is never appropriate for Federal legislation to authorize State tax collection and we are not saying that this bill or something like it is not worthy of consideration. We are suggesting that the circumstances should be studied carefully to see if there are any alternatives to the Federal Government stepping in and, furthermore, that constitutional limits should be closely observed.

Finally, let me comment on the provision of the bill that deals with the Federal information reporting requirements and the use of the IRS to collect information for enforcement of the tax. We have considerable problems with that provision of the bill. As we all know, there are information sharing arrangements between the States and the Federal Government at the present time. However, all of these relate to circumstances under which the States and the Federal Government collect information for their own tax purposes. This bill would impose a separate information reporting requirement imposed by the Federal Government solely for the purpose of giving information to the States. We think that raises an undesirable precedent for the collection of information. Carried to an extreme, of course, there would be no limit as to how far such provisions might go, because there is undoubtedly a lot of information that the Federal Government could collect that would be beneficial to the States. The viability of our Federal income tax system depends on the voluntary compliance by taxpayers who have assurances of the confidentiality of the tax return system. We think that a proliferation of information reporting requirements, where infor-

mation is turned over to others, such as the States, might undermine that confidentiality and would be a weakening in the Federal tax system. Therefore, we are concerned about the information collection feature of the bill. Regardless of the merits of the bill dealing with the States rights to collect and enforce these taxes, we suggest that the provisions of the bill dealing with authorizing the IRS to collect information are unwise and in some respects flawed in their mechanics, therefore, we oppose those provisions of the bill.

[The statement of Mr. Chapoton follows:]

FOR RELEASE UPON DELIVERY
Expected at 10:00 a.m., EDT
May 13, 1987

STATEMENT OF
O. DONALDSON CHAPOTON
DEPUTY ASSISTANT SECRETARY (TAX POLICY)
DEPARTMENT OF THE TREASURY
BEFORE THE
SUBCOMMITTEE ON SELECT REVENUE MEASURES
OF THE
COMMITTEE ON WAYS & MEANS

Mr. Chairman and Members of the Subcommittee:

I am pleased to have this opportunity to present the views of the Treasury Department on H.R. 1242, which would authorize State and local governments to require out-of-state retailers to collect sales and use taxes on interstate sales and require retailers to file information returns with the Internal Revenue Service for the purpose of assisting States in the collection of such taxes. This bill raises important issues concerning the appropriate role of the Federal government in the authorization and enforcement of State and local taxes.

Background

State sales taxes are generally single rate ad valorem taxes imposed on a broad range of personal property (subject to possible exclusions of food, clothing, medical supplies, automobiles, and other items) sold at retail within the State. In some States, the general sales tax also applies to the provision of services, although there is considerable variation as to the types of services covered. Forty-five States and the District of Columbia levy sales taxes, with rates ranging from 2 percent to 7-1/2 percent. Additional sales tax are imposed by over 6,000 local governments. Sales and use taxes account for, on average, over 30 percent of State tax revenues.

In addition to differences in the tax rate and tax base, the legal form of sales taxes varies among the different States. In most States, the sales tax is imposed directly on each retail sale, the base of the tax is the selling price of the taxable item, and vendors are legally liable for collecting the tax. In other States, the legal form of the sales tax is an occupation or privilege tax imposed on retail vendors, the base of which is measured by the gross receipts of the vendor. Whether the sales tax has the legal form of a retail sales tax or a privilege tax, the tax is generally passed on to the consumer and separately stated as part of the purchase price. In fact, many States require that the sales tax be separately stated. 1/ With enactment of the Tax Reform Act of 1986, effective for 1987, the itemized deduction for State and local sales taxes for Federal income tax purposes has been repealed.

1/ For purposes of the now-repealed deduction for itemized State and local sales taxes under section 164 of the Internal Revenue Code, both forms of sales taxes generally were treated as imposed on the consumer, provided that the sales tax was separately stated. See Treas. Reg. 1.164-5; Rev. Rul. 76-87, 1976-1 C.B. 49 (involving a New York State sales tax imposed on the consumer and collected by the retailer); Rev. Rul. 77-465, 1977-2 C.B. 61 (involving a separately stated Minnesota sales tax imposed on the gross receipts of the retailer).

All States that impose sales taxes also impose so-called compensating use taxes on the storage, use or consumption of tangible personal property that would be subject to the State sales tax but for the fact that the property was purchased outside the taxing State. In some States, the use tax is limited to property "purchased for use" within the State and does not apply to property initially used outside the taxing State and subsequently brought into the taxing State. In other States, the use tax may be imposed on used property brought into the taxing State, although the tax base is then usually reduced to the depreciated value of the property. Many States do not apply the use tax to property (whether or not previously used) which is brought into the taxing State after a prescribed period of time after purchase, such as ninety days or six months. With certain exceptions, a credit against the use tax is available in the event that sales tax was paid on the property in another State. As with sales taxes, the itemized deduction for compensating use taxes is no longer allowable for Federal income tax purposes, effective in 1987.

Generally, the State in which a vendor conducts its business operations does not impose its sales tax on property delivered outside the State to residents of another State. Such property would be subject to the sales or use tax imposed by the State in which the consumer resides, with the out-of-state vendor usually required to register, collect and remit the tax on sales to residents of the taxing State. If no out-of-state vendor has collected the sales or use tax of the taxing State, the consumer who brings the taxable property into the taxing State is liable for payment of the use tax. As a practical matter, however, States are generally unable to collect use taxes from individual consumers.

State taxation of interstate commercial transactions and nonresident persons is subject to Federal constitutional limitations. Specifically, under judicial decisions based on the Commerce Clause or, alternatively, on the Due Process Clause of the Fourteenth Amendment, State taxation that falls on interstate commerce or nonresident persons violates the Constitution if the object of taxation does not benefit from State governmental activities. Thus, out-of-state vendors may be required to register, collect and remit another State's sales or use tax, with respect to sales to residents of the taxing State, only if the out-of-state vendors have sufficient business contacts, or nexus, with the taxing State.

It is well-settled that vendors who maintain a place of business within a taxing State may be required to collect the taxing State's sales or use tax with respect to mail-order sales to residents of the taxing State, even if such sales have no connection with a vendor's place of business in the taxing State. See National Geographic Society v. Board of Equalization, 430 U.S. 551 (1977); Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941), and Nelson v. Montgomery Ward and Co., 312 U.S. 373 (1941). Even if an out-of-state vendor has no regular place of business in a taxing State, States may constitutionally require collection of their sales or use taxes if the vendor solicits sales through agents or independent contractors located in the taxing State who are paid on a commission basis. Scripto, Inc. v. Carson, 362 U.S. 207 (1960). However, in the leading case of National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967), the Supreme Court ruled unconstitutional a State's imposition of a duty of tax collection upon an out-of-state mail order retailer who advertised in the taxing State only through mailed catalogues and circulars and delivered ordered products by common carrier. The Supreme Court held that the retailer's limited business contacts were an insufficient nexus with the taxing State and that, therefore, imposition on the out-of-state retailer of the requirement to collect the State use tax was an unreasonable burden on interstate commerce in violation of the Commerce Clause.

H.R. 1242

Based on Congress' authority under the Commerce Clause to regulate interstate commerce, H.R. 1242 would set the minimum business nexus required for imposition of State sales or use tax collection obligations on out-of-state retailers. H.R. 1242 would authorize, but not compel, any State or local government to require out-of-state retailers to collect State and local sales or use taxes on tangible personal property shipped or delivered to the taxing State, if such retailers are deemed to be engaged in business in the taxing State. Under H.R. 1242, the conduct of any one of the following business activities would constitute being engaged in business in a State: (1) deriving rentals from leased property located in the State; (2) broadcasting, printing, or distributing from within the State advertising that is intended to be disseminated to consumers located in the State and only secondarily disseminated to bordering jurisdictions; (3) soliciting orders for tangible personal property by mail if the solicitations are substantial and recurring, and if the retailer benefits from any banking, financing, debt collection, telecommunications, or marketing activities occurring in the State or benefits from any authorized installation, servicing or repair facilities located in the State; (4) sharing common ownership with any retailer engaged in the same or similar line of business in the State; or (5) having a franchisee or licensee which is required to collect the State's tax and which operates under the retailer's trade name.

H.R. 1242 places several administrative restrictions on the imposition of State tax collection duties on out-of-state retailers which, solely by reason of the bill, are deemed to be engaged in business in the taxing State. State and local sales or use taxes must be collected by the State and imposed at a combined rate which is uniform throughout the State. No retailers may be required to account geographically for the collection of sales or use taxes. Retailers that do not have annual nationwide gross sales of tangible personal property in excess of five million dollars would not be subject to the State tax collection obligation.

H.R. 1242 also amends the Internal Revenue Code to require the annual filing of Federal information returns with the Internal Revenue Service by any retailer defined to be engaged in business in a State under the terms of the bill. The required information return would contain the amount of the retailer's annual nationwide gross sales (whether or not the retailer is subject to any State sales or use tax collection obligation), the annual nationwide sales of certain related persons, the retailer's gross receipts from sales of property shipped or delivered to each State in which the retailer's tax collection obligation exists solely by reason of H.R. 1242, and any other information prescribed by the Secretary of the Treasury. The Internal Revenue Service would be directed to share the Federal information returns with State (but not local) tax collection authorities. Normal penalties under the Internal Revenue Code for failure to file Federal information returns would be applicable.

Discussion

Sales taxes and compensating use taxes are an important source of revenue to State and local governments. States that impose sales taxes, have an understandable concern that taxes not be avoided by the purchase of goods from an out-of-state vendor. Enforcement of such taxes against individual consumers is impractical, except where there is independent verification of consumption of out-of-state purchases (e.g., State registration of automobiles or other assets). Thus, taxing States must rely on out-of-state vendors to collect their sales and use taxes with respect to sales made by such vendors. As discussed above,

however, the Constitution limits the authority of States to require the collection of State sales and use taxes by out-of-state vendors lacking the requisite minimum nexus with the taxing State. In particular, the Commerce Clause, as interpreted in the National Bellas Hess case, precludes States from requiring retailers which lack a place of business or other connection to the taxing State to collect sales or use taxes on goods delivered to residents of the taxing State. 2/

H.R. 1242 is intended to curb the loss of State tax revenue which may go uncollected on mail order sales by out-of-state vendors and on cross-border deliveries of goods purchased in an adjacent State. H.R. 1242 involves the Federal government in collection of State sales and use taxes in two quite different ways. First, H.R. 1242 establishes Federal standards of minimum business contacts necessary to subject out-of-state vendors to the tax collection jurisdiction of the various taxing States. While the bill authorizes State imposition of an obligation to collect State sales and use taxes on vendors that satisfy the prescribed minimum nexus requirements, it also requires that the obligation conform to Federal limitations on the collection of State and local sales and use taxes. Second, H.R. 1242 imposes Federal information reporting obligations on interstate retailers, whether or not such retailers are subject to any State sales or use tax collection duty solely by reason of the bill. The Internal Revenue Service would be responsible for collecting and processing the information returns for use by the States and for enforcing the information reporting requirements.

With respect to the authorization of expanded State tax collection jurisdiction contained in H.R. 1242, the Treasury Department is concerned that the prescribed business nexus requirements do not resolve the constitutional questions. Under our Federal system, each State determines, subject to Federal constitutional limitations, the required business nexus that subjects out-of-state vendors to a State's sales or use tax collection system. The United States Supreme Court ruled in National Bellas Hess that the constitutionally required nexus was not present where an out-of-state retailer's only connections with customers in the taxing State were by the mails or common carriers. Imposition of a State use tax collection obligation on the out-of-state vendor was held to burden interstate commerce in violation of the Commerce Clause of the Constitution.

Since the Commerce Clause vests Congress with exclusive authority to make laws respecting interstate trade, Congress may be able to prescribe Federal standards for the requisite business nexus to support State imposition of sales and use tax collection obligations. However, since the reach of State taxing authority is also subject to the Due Process Clause of the Fourteenth Amendment of the Constitution, any legislation prescribing minimum nexus requirements must not violate the Due Process Clause. Unlike the Commerce Clause, the Due Process Clause does not vest Congress with authority to prescribe the minimum nexus requirements necessary to support the extension of State taxing authority.

Although the Supreme Court in National Bellas Hess did not base its holding on the Due Process Clause, the Court noted that the Commerce Clause and the Due Process Clause contain similar requirements of some minimum connection between the State and the person, property or transaction it seeks to tax. National Bellas Hess, 386 U.S. at 756. Thus, out-of-state vendors might challenge on due process grounds any Congressional statute that extends the reach of State taxing authority to the extent struck down in National Bellas Hess.

2/ Notwithstanding the National Bellas Hess decision, States may enter cooperative agreements under which each State assists in collecting and enforcing the sales or use taxes imposed by the other State.

We do not mean to express an opinion as to the constitutionality of H.R. 1242 or as to the broader issue of the constitutional limits of congressional power over State taxes affecting interstate commerce. We only suggest that enactment of H.R. 1242 would not necessarily settle the constitutional issues surrounding the reach of State sales and use taxes.

We are also concerned about certain ambiguities pertaining to the specific nexus requirements prescribed in H.R. 1242. By its terms, H.R. 1242 does not authorize a State to apply its use tax to a mail order retailer whose only connection with customers in the taxing State is through the mails or by common carriers. Thus, H.R. 1242 may not directly overturn the holding of National Bellas Hess. H.R. 1242 requires that the out-of-state retailer make substantial and recurring solicitations of customers in the State and benefit from additional business connections in the taxing State, such as banking, financing, debt collection, telecommunications, or marketing activities occurring in the taxing state or the location of authorized installation, service or repair facilities in the taxing state. It is unclear from the bill's language whether customers' use of in-state banking or credit facilities or communications between retailer and customers by means of telephone or cable television satisfy the bill's nexus requirements. There is no definitive Supreme Court decision on whether such contacts satisfy the constitutional business nexus requirements. It may well be that H.R. 1242 simply authorizes application of State sales and use taxes in circumstances that would be constitutionally permitted in the absence of the legislation. 3/

Obviously, Congress should, in certain circumstances, exercise its authority to preserve important Federal legislative interests that may be threatened by the application of particular State and local taxes in the realm of interstate commerce. The Federal Government has a strong interest in ensuring that State taxing authority does not unduly interfere with international commercial interests of the United States. 4/

The Treasury Department wishes to express its opposition to the Federal information return provisions in H.R. 1242, which would involve the Internal Revenue Service in collecting information wholly unrelated to the administration and enforcement of Federal tax laws. The sharing of Federal tax return information with State tax authorities, subject to stringent confidentiality restrictions, has long been sanctioned by the Internal Revenue Code. Of course, under existing information sharing procedures, the Internal Revenue Service and State counterparts exchange information taken from tax and information returns which are filed to comply with each jurisdiction's own income taxes. H.R. 1242 would impose independently enforceable Federal information return obligations solely for the purpose of providing information to State tax authorities for sales and use tax purposes.

3/ In fact, the Supreme Court's opinion in National Bellas Hess did not mention the use by the mail order customers in that case of in-state banking and credit facilities -- a fact that the dissenting opinion in the case regarded as sufficient to establish the requisite constitutional nexus. National Bellas Hess, 386 U.S. 753, 761-62 (Fortas, J., dissenting).

4/ For example, there is a strong Federal interest in restricting the reach of State-imposed unitary taxes that include in the tax base income or assets of foreign corporations beyond the "waters edge" of the United States. While the Administration remains hopeful that the unitary tax issue will be resolved by State legislative action, if more progress is not achieved on this issue by the States, we may again have to urge enactment of Federal legislation in this regard.

We believe that H.R. 1242 sets an undesirable precedent in requiring the Internal Revenue Service to enforce the filing of information returns wholly unrelated to Federal tax liabilities. Moreover, the viability of the Federal income tax system depends upon voluntary compliance by taxpayers who receive assurances of the confidentiality of their tax returns. A proliferation of information return filing requirements that obviously serve no Federal tax purpose might invite taxpayer skepticism about the confidentiality of all Federal tax and information returns.

The information filing requirements contained in H.R. 1242 are also flawed in their details. H.R. 1242 literally requires all retailers with interstate sales to report the volume of annual nationwide sales, whether or not the amount of such sales exceeds five million dollars, and whether or not the retailers are subject to any State sales or use tax. Additionally, H.R. 1242 would require retailers to report to the Internal Revenue Service gross receipts on sales of property delivered to a State with respect to which sales or use taxes are required to be collected solely by reason of H.R. 1242. It may be difficult for any retailer obligated to collect another State's sales or use tax to know whether the obligation arises solely by reason of H.R. 1242. In fact, since it is not entirely clear that H.R. 1242 expands the constitutional reach of State sales and use taxes, it may be that no State sales and use tax collection obligations can be said to apply to out-of-state retailers solely by reason of H.R. 1242.

Thus, independent of any action taken to authorize imposition of State sales and use tax collection obligations on out-of-state vendors, the Federal information return requirements contained in H.R. 1242 seem unworkable and imprudent. We believe they should be deleted from the bill.

I would be happy to answer any questions.

Mr. CHAPOTON. Mr. Rangel, I would be happy to answer any questions that the members might have.

Chairman RANGEL. Mr. Secretary, do you feel the Federal Government has any role in assisting the local and State governments in the collection of sales taxes?

Mr. CHAPOTON. Mr. Chairman, I think that it might well have a role in this area if there is no other alternative.

I think, though, that we need to study very carefully the constitutional limitations that the Supreme Court has laid down. And in doing so, we should probably first consider whether there are other alternatives to the Federal Government stepping in here, such as the States getting together. We know there is some evidence of State compacts and State agreements where they are cooperating with each other in collecting their taxes. We wonder if that might provide a solution to this before the Federal Government acts in this regard.

Chairman RANGEL. You indicated that the Treasury was looking at the problem and, I guess, trying to come up with some recommendations. Is there a study going on now?

Mr. CHAPOTON. It is not a Treasury study, Mr. Chairman. There is a White House working group that was established in the last couple of years that is studying the overall problem of federalism. This is one area that it is studying as well.

Chairman RANGEL. Do you have any idea what the time table is as to when this study would be completed?

Mr. CHAPOTON. No, I do not and I am not certain of the progress of the study on this specific issue. I might be able to check into that and report back to you.

Chairman RANGEL. Well, if you assume that the Congress believes that the thrust of this legislation has merit, could Treasury assist us in making recommendations that would remove from it some of the objections that you have testified about this morning?

Mr. CHAPOTON. We would be happy to assist in that regard, but one of our suggestions is whether it is premature to act at this time—whether the States are moving in the direction that might satisfy the overall problem without the Federal Government acting at all.

Chairman RANGEL. Well, we are going to have to assume that if the Congress believes this is being handled without the need of Federal legislation that we would not move and that is the purpose of the hearing.

But if it is concluded that the States do need some assistance and there is a hemorrhage in revenues that are lost—and we are going to legislate—I will assume that we can depend on Treasury to at least remove the technical objections that you would have.

Mr. CHAPOTON. Absolutely.

Chairman RANGEL. Mr. Dorgan.

Mr. DORGAN. Mr. Chairman, let me just say that I think we are well past the question that Mr. Chapoton asks, is there something the States can do? Is there a State compact that can overcome this? We are well past that issue.

This area has been studied to death. It is time now for us to do something and do the right thing.

As I understand from your testimony, Mr. Chapoton, you object to the reporting requirement because it would add another burden to the Internal Revenue Service.

I view it as a relatively small burden. It is a reporting requirement that probably is fairly straight-forward. I read your statement and you cover most of the bases here, but you seem to be objecting mostly to the reporting requirement.

I thought I heard you say that in the White House there is now a study ongoing on the *Bellas Hess* issue?

Mr. CHAPOTON. It is on the broader issue of federalism in the government. It is a White House task force, working group.

Mr. DORGAN. Is it fair to say, then, that there is no one in the White House at this point that is looking specifically at how to overcome the *National Bellas Hess* case and how to allow the States to get at that revenue?

Mr. CHAPOTON. I am not sure. I think that is one of the issues the working group is addressing, but how specifically they have addressed the issue is unclear to me.

Mr. DORGAN. That would be the first I have ever heard of that and I do not know of anybody else who has ever heard of that.

So, if there is a specific inquiry going on in this administration about the issues surrounding the *Bellas Hess* case, it would be advantageous for us to know that. My best guess is that is not the case.

But, again, I do not know. I would guess the study of federalism involves a whole series of things, but there is no one focussing on the revenue consequences or the fairness issue surrounding the *Bellas Hess* issue.

Mr. CHAPOTON. Well, I think the study is not focussing on revenue implications but rather on the overall concept of federalism and in that sense takes in *National Bellas Hess.*

It was my understanding that they have actually addressed the *National Bellas Hess* issue.

Mr. DORGAN. But, I guess, the point I would make to you with respect to federalism is that in step with the administration's view of federalism, one would have expected you to come up here to give full-fledged, unqualified, unconditional support to this sort of thing.

This sort of thing gives State governments the ability to get the revenue they ought to get from a series of activities that are occurring at that point tax free.

It seems to me to be consistent with the whole notion of the Federal Government's view of the States strengthening their role, assuming more responsibility themselves, that it would have been in keeping with the Treasury to say, "Absolutely, this is something we ought to do. It is something we support."

Mr. CHAPOTON. Well, I think—let me hasten to add, we have not objected. We are not opposing this bill. It is just that the bill raises questions with which we are not yet comfortable. It raises constitutional questions. It raises questions about whether this is the right way to go, whether this is the right nexus, whether these de minimis limitations are the right ones, how we deal with the differences between the local city and county taxes versus the State taxes, geographical reporting requirements, things of that nature.

So, I guess we are not ready to say this is the way to go and I—but I think that you are right, that the idea that the States can accomplish this in some fashion is very appealing to us and perhaps some Federal Government help is necessary.

Mr. DORGAN. So, if you are not opposing the bill, as you indicated, and the idea is appealing to you, it is safe to say that with the exception of the queries you have about some details, generally speaking, this is the sort of thing the administration would view with favor?

Mr. CHAPOTON. I think, generally speaking, that is true. But in view of the problems which have been raised, we, I guess, would have some hope that it could be accomplished at the State level. Now, you obviously have more experience than any of us dealing with that and you are very pessimistic that that can occur.

Mr. DORGAN. Well, I am just telling you it cannot occur. I think that there are plenty of people, some awfully good minds, a lot of talent, who have focussed on this problem for many years and it cannot be accomplished by State compact.

It cannot be accomplished by any other approach in my judgment except passage of the kind of legislation that I or Congressman Brooks has introduced.

But I do appreciate your testimony, Mr. Chapoton.

Chairman RANGEL. Mr. McGrath?

Mr. MCGRATH. Thank you, Mr. Chairman. As I understand some of the points in this legislation, the amount of sales tax that can be collected is only that amount which State collects for itself, plus the lowest amount for any jurisdiction within that particular State.

Now, in New York State, for instance, we have 62 counties. The State sales tax is 4 percent and I think the local sales tax, by either city—I think New York City has its own—or any other county ranges between 1 and 4½ percent—I think mine is 4½ percent—for a total of 8½ percent.

Is it my understanding then that the sales tax to be collected or charged by some out-of-State company could only, therefore, be 5 percent in New York. Am I correct?

Mr. CHAPOTON. That is my understanding of the bill as well.

Mr. DORGAN. This bill allows for the collection of the sales or use tax at the State imposed level.

Mr. MCGRATH. Now, if the State sales tax is 4 percent, then 4 percent would go to the State and the 1 percent difference would then be split up between the counties from which they come.

Mr. CHAPOTON. Well, I think that is one of the uncertainties of the bill. I think that the intent of the bill is that the maximum amount of the tax allowed under the bill would be the State tax plus the lowest local tax.

Mr. DORGAN. Let me clear that up. There would not—if the State sales tax is 4 percent, there would not be a collection of 5 percent.

This bill would allow for the State to impose its State sales or use tax.

Mr. MCGRATH. As I understand it, plus 1 percent for the county from which it emanated, the lowest county jurisdiction within that particular State.

As I understand it, in New York State—you could only collect 5 percent.

Mr. DORGAN. There is no provision in the bill for that. The bill would deal with the State imposed sales tax rate. Now, there are questions that will be raised today, I am sure, about whether or not this should include other jurisdictions.

I understand the State of New York has something like 80 jurisdictions that impose a sales tax.

Mr. MCGRATH. Correct.

Mr. DORGAN. That is a legitimate question to ask, should this include all the local jurisdictions or none of the local jurisdictions or just the State jurisdictions.

Mr. CHAPOTON. The language of the bill says that the power to collect a State and local sales or use tax arises only if the tax is imposed at the same rate on the same transactions in all geographical areas of the State." I assume that meant that if a local sales tax existed of 1 percent and it was at least that much in all areas of the State, then you could add that to the State tax.

Mr. MCGRATH. That is the understanding that I had. That there was a State floor, plus the lowest of the jurisdictions added to the State.

And under that circumstance, if that is the case, then I wonder whether or not the State would get the 4 percent, and the rest of the jurisdictions would divvy up the 1 percent. Or would the 1 percent go to the jurisdiction from which the sale emanated?

Mr. DORGAN. Let me just explain. The purpose of this bill is not to be collecting the local taxes. It is to deal with the State taxes.

If a State would have a uniform tax in all geographic areas of the State, this bill will allow for the collection of that, but there is no state that has that condition, so this bill really deals with the imposition of the State sales or use tax.

The question is open. Should it deal with more? If it does, how should it be distributed, but this bill does not do that.

Mr. MCGRATH. I would say to my colleague that most of the information I have received supporting this bill has come from localities and cities and not the States.

And I am sure that if they found out that they were not included in this piece of the pie that they would withhold their support to the extent that they have given it at this point in time.

Let me ask you another question. Is there any provision that this particular sales tax would be shared among jurisdictions within the State or is that strictly up to the State?

Are there any jurisdictions? The sales may come from anyone. In the case of New York, 62 counties, that have sales taxes. Why should the State get all of it if it comes from one of the counties which also has a sales tax?

Mr. CHAPOTON. I think under the bill that is left up strictly to the States. I think the intent is that there be a single collection by the State and they decide how to distribute the money.

Mr. MCGRATH. Let me ask you just one other question, not on the distribution, but on the accessibility of the records of the catalog house to the State and to other jurisdictions.

If you tell me that other jurisdictions are out, then perhaps they are just out. But every State would have access to the records of this particular catalog house to make sure that their sales taxes were collected?

Mr. CHAPOTON. Under the bill, each State would have access to the records relating to its State. The retailer would be required to supply information to the Federal Government on information returns dealing with its overall sales and with its sales to each particular State.

Mr. MCGRATH. Mr. Gregg is going to, on his own time, I suspect, bring up what my understanding of the bill is, and, if that is the case, where counties would share, would the bill provide for counties to have that same access?

Mr. CHAPOTON. I think the bill is related solely to sharing information with the States. But, frankly—I am advised there is no information sharing with local authorities. The information sharing would be only at the State level.

Mr. MCGRATH. I thank the gentleman for his testimony.

Mr. DORGAN [presiding]. The Chair would advise the gentleman from New York that there will be testimony today from a representative of the League of Cities and they specifically will make the case that this kind of legislation should be broadened to include the imposition of a tax or the collection of a sales and use tax by a mail order seller for local governments as well.

Mr. MCGRATH. Well, I would expect that they would if they imposed a sales tax on their local jurisdiction. I will tell you I think perhaps it is going to complicate the issue substantially, but let us see how it works out.

Mr. DORGAN. Mr. Andrews?

Mr. ANDREWS. You mentioned in your statement Treasury's concerns about the constitutionality of H.R. 1242. And I really share those concerns. I have got some problems with the nexus myself.

For instance, in the *Bellas Hess* case, as I understand it, is a Delaware corporation that was licensed to do business in Missouri as its principal place of business.

There was no advertising. There were no agents. There was literally no connection other than a mail solicitation to its current customers and potential mail order customers. Everything was literally handled through the mail. There was no phone number, office, or post office box within the State.

Mr. CHAPOTON. The only additional fact was the delivery of the goods that were purchased through a common carrier.

Mr. ANDREWS. Exactly. Now, in Mr. Dorgan's bill, he sets out five elements, any one of which triggers the nexus.

Mr. CHAPOTON. That is correct.

Mr. ANDREWS. In addition, as I understand it, the bill by Mr. Brooks has an additional requirement of a minimal amount of sales.

For instance, if an out of State company has a half million dollars in sales a year, that is an element that might trigger the nexus.

Mr. CHAPOTON. No, I think, Mr. Andrews that would not trigger the nexus. That dollar amount is an exception to the nexus, it is a de minimis exception.

Mr. ANDREWS. Right, below $500,000—I was previously referring to those sales above $500,000.

Mr. CHAPOTON. If it is above $500,000——

Mr. ANDREWS. That is an element that triggers the nexus.

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Mr. CHAPOTON. No, if it is above $500,000, then under the Brooks bill you are back to just the regular test which is whether the seller engages in regular or systematic solicitation of sales in the State.

Mr. ANDREWS. Give me your thoughts, then, on how we legislate a bill that does meet the requirements of *Bellas Hess*. How do we get around the *Bellas Hess* case?

Mr. CHAPOTON. An argument can certainly be made under a narrow interpretation of *National Bellas Hess*, since it relied principally on the commerce clause, that absent Federal legislation the commerce clause restricts enforcing a tax under factual circumstances such as are present in *National Bellas Hess*—there is very little contact. But if the Federal Government steps in and cedes the taxing authority to the States under that factual circumstance and says that it is an element of interstate commerce that the States can deal with, then under the commerce clause, States may then be able to tax without violating the Constitution. In other words, it would be a legislative overturn of *National Bellas Hess* with respect to the commerce clause. I think it is not entirely certain that that can be done under the commerce clause, but certainly a good argument can be made that that can be done.

The concern presented, though, even if that can be done under the commerce clause, is whether there is sufficient authority under the due process clause to do likewise. In other words, can the due process clause be expanded by Federal legislation. I think that is unclear, so that is a murky area.

Mr. ANDREWS. And just to follow up on your response, in the *Bellas Hess* case, it quoted—or it set out the test on the due process clause which is simple: It is whether the State has given anything for which it can ask in return.

Mr. CHAPOTON. Right.

Mr. ANDREWS. I mean, that is what the test—and that is your concern, applying that test to a fact situation that would be controlled by this legislation?

Mr. CHAPOTON. That is correct, whether that fact situation would constitute giving anything which benefits the taxed party so that the State can impose its tax, which is, as you said, the Supreme Court's requirement for due process.

Mr. DORGAN. Mr. Gregg?

Mr. GREGG. I would like to express my very serious reservations about, and, in fact, my strong opposition to, the concepts of this bill. Many of the points that concern me have already been outlined in testimony.

I particularly find the constitutional arguments to be fatal to the bill. I do not see any way that the due process clause could be elastic enough to cover the proposed tax scheme.

It seems clear that mail order houses are not going to receive due process if they are taxed in this manner. I just do not know how we can ever get around that.

Even if you could get around the commerce clause arguments—which I really do not think we should even be trying to get around—I do not see why the Federal Government should be invading the area of State sales tax.

In addition, I think the administrative nightmare that this bill would create is immense. From your testimony, it is fairly clear that under the bill, as construed by one of its authors, 46 States, at least, would have the right to audit these retailers.

I presume the retailers would therefore have to maintain a working knowledge of sales tax law in 46 States. Is that correct?

Mr. CHAPOTON. It would have to have some information on that, because if the selling company was required to collect a tax for a sale going to another State, it would have to know something about the details of the tax of that State.

Mr. GREGG. And it is very possible that the mail order houses could end up being the payer of last resort on this tax. Right?

Mr. CHAPOTON. I suppose that is correct as well.

Mr. GREGG. So, they might have to set up a new bad reserve—for which they could probably even get a tax deduction—for sales taxes the retailers do not know are owing and which are not paid by the customers. Right? What number would they put in that column in their accounting basis?

Mr. CHAPOTON. Well, I think that would depend upon how the individual State sales tax read. There is a duty to collect the sales tax and probably under the State tax law, if they fail to act properly to collect it, they would be liable for the tax.

Mr. GREGG. And then there would be 46 State auditors flying in in their private jets supplied by the local State of North Dakota or Illinois or wherever, and landing at the airports, which are used—where the runways would be too short for them. I do not know how they are going to get into the airport at Freeport, Maine.

But in any event, landing on a daily basis, 46 times every year, possibly. Maybe they would come twice a year because Maine is a really nice place to visit and New Hampshire is too. They would like to come to Brookstone, maybe, and Peterborough twice.

Does this not create a massive overhead, an administrative nightmare to be subject to audit from 46 different States?

Mr. CHAPOTON. We can only speculate exactly how it would work out. The selling company would be responsible to each of the 46 States if it sold in each of those 46 States.

Mr. GREGG. And they are going to want to get their pound of flesh. They are not just going to let that company that is generating $100 million in sales, like I believe L.L. Bean does, or even maybe $5 million in sales like a small mail order house in North Dakota, sit there with all that tax revenue potentially sitting in an account somewhere.

They are going to want to get theirs before New York gets theirs and New York is going to want to get theirs before Texas gets theirs. And they are all going to want to get in there.

Mr. CHAPOTON. Of course, the argument can be made that by selling in those particular States that the retailer is becoming involved with that particular State and it is competing with retailers located in that State, who also must comply with the laws of that particular State, so that——

Mr. GREGG. Well, I suppose the argument could also be made that when somebody from Massachusetts drives to Connecticut and buys goods in Connecticut, he should be followed by the Massachu-

setts auditors into Connecticut so they can audit the Connecticut salesperson.

But let us accept the fact that what we are creating here is an administrative nightmare for these houses that is Byzantine at best.

Plus, as I understand it, the Municipal Association is going to address the issue and they want to be covered. That adds 6,700 more municipalities that have a tax situation.

So, we are talking about 6,746 potential audits, if we include municipal associations.

Mr. CHAPOTON. Theoretically, if the company sold in every one of those jurisdictions, it applies.

Mr. GREGG. They probably do, right? That means that there are not enough days in the years to even allow three or four auditors in at a time under that scenario.

I can understand where States would like to get their sales tax, but I do not think that structuring a situation where you first violate the Constitution under two clauses and then create an administrative situation that is going to generate massive situations of overhead is the way to approach it. Thank you.

Mr. DORGAN. Would the gentleman yield just for a moment to correct the record on something.

I expect that the record should be corrected to point out that this is not a tax imposed on the mail order firms. The tax is imposed upon the customers.

The requirement by this bill would be that the mail order firms collect the tax. Is that not right, Mr. Chapoton?

Mr. CHAPOTON. That is correct. The tax would be imposed by the particular State, is that what you said, and it is not imposed by this bill. The bill merely authorizes the States to enforce it in this fashion.

Mr. DORGAN. The tax is imposed on the customer and the requirement to collect the tax is imposed on the retailer or mail order firm.

Mr. CHAPOTON. That is right.

Mr. GREGG. Of course, continuing my time, that is in a manner that has already been ruled Unconstitutional unless—under the commerce clause—and is significantly suspect under the due process clause. Is that not correct?

Mr. CHAPOTON. Unless there is sufficient factual nexus, that is correct.

Mr. DORGAN. Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman. Mr. Chapoton, I would like to give you a hypothetical. I understand the limitations of responding to something like that off the cuff, but if you could shed some light on it, I would be interested.

Let us assume H.R. 1242 passes and someone offers for sale products in a State that does not have a sales tax. The advertisement reads, "We want to sell you these products. We will deliver them to the State of Nevada, or wherever they do not have a sales tax, where your agent will take possession of them. We will do as you instruct your agent. If you wish to instruct your agent to mail the products back to your home, you may do so by indicating that on

this form and forwarding the appropriate amount of money to your agent in that State."

Thus, the "National Catalogue Co." or whoever is selling the product has not sold into that State, but has sold, in effect, into Nevada. Would you see any sales tax liability being due to the particular State under that circumstance?

Mr. CHAPOTON. To the State in which the customer lives? That is the——

Mr. BROWN. That is right.

Mr. CHAPOTON. Well, that depends—it is a little bit like a law school exam, Mr. Brown. I think that would depend upon where title transfers. Let me go back and say that this bill really addresses the question of collection of that tax more than it does whether the tax is appropriately imposed and those are interesting constitutional questions.

I do not think, if I understood your question right, if the purchaser lived in Texas then I think Texas could impose a sales, or for that matter a use tax, even if the title did not change hands in Texas on the Texas customer. But how it can collect that tax is the difficult question.

Mr. BROWN. Well, let us say title transfer and delivery took place in Nevada for a Texas resident. Clearly, there would be no sales tax.

Mr. CHAPOTON. No sales tax, but you still have the use tax and the use tax is generally applied for the use of products purchased by a resident of the State if the sales tax does not otherwise apply.

So, disregarding my constitutional point on that, I think if the customer lived there and if the use tax was appropriately prescribed, then it could apply to the purchasing customer even in that circumstance.

But, again, the collection of the taxes is the difficulty.

Mr. BROWN. Under that scenario, would not the use tax apply only when the product was brought into Texas and therefore not be applied to the nationwide retailer?

Mr. CHAPOTON. The tax would apply only when the product is brought into Texas. But the tax is not on the nationwide retailer. The tax is imposed, in most cases, on the customer.

Mr. BROWN. I guess that my point is that there is an easy way around the tax system we have structured now.

Let me explore a little further, if I could, how the proposal is going to work. Is it not the case that States require a license to do business in the State?

Mr. CHAPOTON. Many States do, yes.

Mr. BROWN. Then, what we are talking about, if we pass this proposal, is not just a collection of a tax. We would perhaps be also requiring the filing of forms in many States by each nationwide retailer to obtain a license or authority to do business in the State?

Mr. CHAPOTON. Well, I think that gets into a broader question, but I am not entirely sure. There are fairly broad constitutional principles set up regarding under what circumstances an out of State corporation has to acquire a license to do business in a particular State—and usually sales through interstate mails do not go that far. And I am sure this bill would not be intended to go that far. It would merely intend to say that if the sale is made that the

tax, which is properly owed by the local consumer, can be imposed against the selling company. Whether a State would take it to the next step and say the selling company thereby is required to register in the State to do business, I do not know.

Perhaps, though, I think your point is that even if the Secretary is not registered to do business, it is registered to make this sale so that it has to pay some tax. There is some connection there because this bill would be establishing some sort of a nexus and that is an interesting question. Just how that contact would be established and maintained for the collection of the tax——

Mr. BROWN. I guess it really depends on the State law.

Mr. CHAPOTON. I think it depends entirely on the State law.

Mr. DORGAN. I would like to point out that we will have witnesses on future panels from State governments and other places that will be able to answer those questions, I believe.

Mr. BROWN. That would be very helpful. I am wondering if H.R. 1242 would also require the national retailer to file income tax forms in the 46 States into which they are making sales?

Mr. CHAPOTON. Well, I think that, too, would depend on both constitutional limitations and the particular State income tax laws, but I suspect it would not. This particular bill would, of course, require the filing of information returns with the Federal Government, but only for purposes of information to the States.

I do not think retailers would be held to be doing business for the purposes of filing a tax return in the State of the purchasing consumer. But those are the sort of questions that do need to be addressed.

Mr. BROWN. What if a State says that it wants to license anyone who sells in the State. Does this bill in any way enhance the State's ability to license those salesmen?

Mr. CHAPOTON. You mean the bill would say that any salesman in the State has to be licensed? I do not think this bill would touch on that one way or the other.

Mr. BROWN. How about inspection of products that are coming into the State? Let us assume a State has particular inspection requirements or product review requirements.

Mr. CHAPOTON. Again, I do not think this bill——

Mr. BROWN. Would touch on this?

Mr. CHAPOTON. Was intended to address that.

Mr. BROWN. The question of interstate commerce is an intriguing one. I assume that local retailers are far more influential in a State's legislature than national retailers located elsewhere. Is it possible we are creating the potential for local retailers simply to outlaw their competition? Is this bill really a hidden way to outlaw out of State competition by mail order sales?

Mr. CHAPOTON. Mr. Brown, I do not really feel qualified to answer that, but I would think it is certainly not the intent of the bill to do that. Obviously, by imposing a local tax on out of State retailers, it has an impact, but I do not think under the commerce clause or under this bill any State could actually outlaw or prohibit sales in interstate commerce.

Mr. BROWN. But by providing a nexus, do we provide not only a handle for the collection of sales tax, but a handle for the imposition of a wide range of additional State regulations?

You see, what concerns me in this bill is providing a nexus for State regulations and statutes to apply to out of State retailers.

By doing that do we also create the potential for States to apply nontax restrictions and regulations?

Mr. CHAPOTON. Well, I think the bill should be specific in that regard, because the bill purports to be a grant of authority under the Constitution, the grant to the States under the commerce clause.

And in that regard it should be limited, which is the point you are making. I believe that any such authority granted to the States should be very limited and directed strictly to the sales or use tax that the bill seeks to aid the State in collection of.

While your questions may be fairly raised, my reading of the bill would not indicate that it is that broad.

Mr. BROWN. Thank you.

Mr. DORGAN. Thank you very much for your testimony.

Mr. CHAPOTON. Thank you.

Mr. DORGAN. At the request of the chairman of the committee, I am going to make one change in the order of appearance and we are going to call next on the Honorable James R. Thompson, Governor of Illinois, representing the National Governors' Association.

The chairman of the committee, of course, a Member of Congress from Illinois is on the floor of the House at the moment working on the debt ceiling bill. He sends his regrets that he is not able to be here, but wanted you to know that he is over on the floor.

He wanted me to extend to you, Governor Thompson, his best wishes and his appreciation for your appearance here today on this issue.

The chairman has indicated that he is very interested in this issue and in working to craft a correct solution to this problem and we welcome you to the committee, Governor Thompson.

We would be glad to include your statement in its entirety in the record and hope that you would summarize your testimony for the committee.

STATEMENT OF HON. JAMES R. THOMPSON, GOVERNOR OF ILLINOIS, COCHAIRMAN, STATE WORKING GROUP ON OUT-OF-STATE SALES TAXES, NATIONAL GOVERNORS' ASSOCIATION

Governor THOMPSON. Mr. Chairman, thank you very much. I appreciate first the courtesy of the Chair and the members of the committee in allowing me to appear out of order.

The Illinois General Assembly is currently in session. I have proposals pending before it having to do with budget and taxes and I also have a number of appointments on th · Hill this morning and this afternoon, so I appreciate very much the courtesy of being allowed to testify in a summary fashion this morning. Please convey my regards to the chairman.

I thank him for his greeting and wish him success on the floor in the management of what is going to be a difficult bill.

Mr. Chairman, I represent, together with my cochairman, Governor Sinner of North Dakota, the National Governors' Association, which is in support of the efforts that have been put forth in this session of the Congress to allow States—which impose sales or use

taxes on transactions occurring within their State—to require out of State vendors who come into the State by means of radio, television, or the print media, to, in exactly the same way that in-state retailers do, collect sales or use taxes imposed on the transfer of goods.

The litigation in the Supreme Court of the United States, *National Bellas Hess* v. *Illinois Department of Revenue*, originated in our State. We, like other States, have been grappling with this growing phenomenon of a greater and greater share of the retail market of America being captured by direct mail order efforts and increasingly by radio and television.

You have my written testimony and I am going to just highlight I think those things that are most important to me as a Governor and to my fellow Governors.

First, at a time when both the administration and the Congress are, in my view, rightfully expecting states to do more, to assume a greater share of the State and Federal partnership—programs involving education, human services, economic development, infrastructural repair and building anew—things the States should be doing.

At a time when this Congress is attempting to grapple with the Federal deficit, as I believe they properly should, and the Governors have long had a leadership role in the effort to reduce the Federal deficit, we find ourselves somewhat handicapped by the current state of the law with regard to the collection of sales and use taxes from out of State retailers.

Estimates of ACIR indicate that anywhere from $1 to $1½ billion of taxes that are properly imposed by States, but cannot be collected, are being lost to States in traditional areas of revenue.

In my State, the estimate is at least $90 million annually. It is $90 million a year that we do not have to replace lost or diminished Federal funding.

And, so, this offers the Congress a rare opportunity to help us become more responsible partners in the Federal/State partnership by giving us what we had believed to be our rightful authority, to collect these taxes, so we can do more at home, while you do less in Washington and the Federal deficit is set more nearly correct.

So, I make my first appeal to you on the grounds that you would be strengthening the State/Federal partnership and enabling us to carry out the responsibilities that we believe ultimately should be held by States, standing on their own two feet, which we are currently disabled from doing by at least $1½ billion a year.

Second, we hear, for example, in the area of trade legislation, much about the necessity to find a level playing field between America and its trading partners. And I think all of us agree with that.

What constitutes a level playing field is still a bone of contention.

But that state of affairs, that level playing field, has an application here as well, because in the current contest for a portion or a market share of consumer business in the Nation, in retail sales, there is no level playing field—when one side consists of traditional retailers, whether in large downtown stores, in huge suburban shopping malls or on Main Street America—in our small towns or

rural areas where 23 percent of the population of Illinois, for example, still lives.

That is so for two reasons. One is inherent in the business and it is not the business of State government or of Congress, and that is simply the fact that direct mail retailers may, with just in time inventory philosophies and huge warehouses and computers and back office clerks, compete very substantially with traditional retailers who have to maintain large stores and a much different structure of personnel.

We are not trying to do anything with that inherent competitive advantage for one type of marketing over another.

But then along comes the ability of the out of State mail order or television houses not to collect sales or use tax for the receiving State, which gives them a price differential of anywhere—for example, in my State—between 5 and 8 percent. Quite a significant margin on a retail sale.

To the extent that the ability of the out-of-State marketer to make the sale over the traditional retailer rests on that sales tax and use tax differential, we think this Congress ought to level the playing field. That is the second good reason for passing legislation of the sort pending before this subcommittee.

The third is a matter that really bothers me as a Governor, seeing where society is going and looking for ways to improve and to enhance economic opportunity.

And I do not think it is one that has received enough attention with the focus on things like "nexus." How do you treat the local sales tax jurisdictions and what does the Constitution really require and how much money is really being lost and the inherent nature of the competition between direct marketers and traditional retail merchants. And that is, what is the ultimate impact on the social fabric of America going to be if this unlevel playing field continues and more and more of market share is taken by radio, television and catalogue salesmen of merchandise.

My fear is that late in this century or at the beginning of the next century, this greater market share will be taken by the direct marketers.

Traditional retailing in America, as we have known it, for more than a century, is going to start to dry up in small town America, in rural areas where retail merchants are already hard pressed by consistent recession in agriculture and mining, for example, in suburban neighborhoods, in inner cities.

For all the quality of the goods sold by the direct marketers in far away stretches of the country, they are not going to support the Rotary or the Lions or the Kiwanis, the Chamber of Commerce or the Little League in the small towns and suburban areas into which these goods are being sent.

A relationship between traditional retail marketing, traditional retail stores and the social fabric of the community is a strong one.

Maintain this artificial price discrimination, ranging on retail sales to a high level, and we will soon see the traditional partnership between local retailing and the rest of the community start to slip away.

Mr. Chairman, as the market share goes from 12 percent to 14 percent to 20 percent to 25 percent after the turn of the century,

with television marketing almost doubling every year, I worry about what the impact on the social fabric of small towns and rural areas is going to be.

Those are the three primary reasons why I support and why I believe all the Governors support this legislation. I would be pleased to answer questions.

[The statement of Governor Thompson follows:]

STATEMENT OF HONORABLE JAMES R. THOMPSON
GOVERNOR OF ILLINOIS,

MEMBER OF THE EXECUTIVE COMMITTEE and
PAST CHAIRMAN OF THE NATIONAL GOVERNORS' ASSOCIATION, AND
CO-CHAIRMAN OF THE STATE WORKING GROUP ON OUT-OF-STATE SALES TAXES

Mr. Chairman, thank you for the opportunity to appear before you today, on behalf of the nation's Governors, to discuss legislation to clarify the right of states to collect sales and use taxes on out-of-state mail order sales. I want to thank Rep. Dorgan for introducing H.R. 1242, the Interstate Sales Tax Collection Act of 1987. As co-chairmen of the National Governors' Association (NGA) State Working Group on Out-of-State Sales Taxes, Governor George Sinner and I have worked actively with governors and other interested organizations to promote a fair and equitable solution to this problem.

As I stated before the Ways and Means Committee in February, it is imperative that Congress address the need for legislation that will correct the impact of the 1967 Supreme Court decision in National Bellas Hess v. Illinois Department of Revenue. This decision prohibits states from collecting state use taxes on interstate mail order firms unless the seller has a presence in the state levying the tax. The underlying principle for this decision was the commerce clause in the Constitution. We are asking Congress to return to the states the taxing powers that existed before federal intervention. We are asking that states be given the right to strengthen and enforce already existing taxing authority. This is not a new tax or a tax increase.

There are many misconceptions surrounding this issue. For instance, many Illinois residents think they are paying a sales tax on their purchases when, in fact, they are paying a use tax to the retailer. The retailer then pays this as a sales tax (Retailers' Occupation Tax) to the state. The retailer thus becomes an agent of the state for collection of the sales tax from consumers. This has worked well for businesses within the state.

However, this process does not work for purchases made by Illinois residents from out-of-state retailers. And, as a result of National Bellas Hess, out-of-state retailers are not required to make sales tax payments to the state unless they have what is commonly called "nexus" within the state. The courts said that businesses do not have "nexus" if their only contact with the state is through mail-order sales or through delivery to a customer in that state.

The court's decision eliminated the obligation of out-of-state direct marketers to collect these use taxes from purchasers and remit them to the purchasers' home state. The court also ruled that Congress had to authorize the states to collect such taxes from out-of-state businesses. The NGA feels that the court's reasoning for giving special treatment to mail-order firms has proven over-time to be faulty, especially in light of the dramatic growth of the direct mail business over the 20 years since the court decision.

The decision clearly puts in-state businesses at a disadvantage with out-of-state and border-state businesses, which have no obligation to collect and remit Illinois sales or use tax. Not only are in-state businesses being forced to compete with these businesses, but they must continue to collect and pay the state tax.

And, of course, the state loses money. In Illinois that amounts to about $90 million annually. The national figure is estimated to be over $1.5 billion annually, and this figure will grow dramatically in future years.

The impact of this revenue loss is becoming more critical as federal programs are reduced, forcing states to pick up more and more costs for vital services -- services that affect our educational, medical, and transportation needs.

According to the Advisory Commission on Intergovernmental Relations (ACIR) thirty-eight of the forty-six states that have a sales tax lost at lea. $10 million each in sales tax revenues in 1985 (the last year that figures were available for comparison). Mr. Chairman, we are having these figures updated for 1987 and will make them available to the committee. States cannot afford to continue to ignore the consequences of National Bellas Hess.

I can certainly understand, Mr. Chairman, how this has come to pass. I'm sure in your household, like mine, you have seen an unbelievable proliferation in the number of mail-order catalogs. It used to be that you could expect to see an array of catalogs from around the country at Christmas time. Now, not a day goes by without at least one, and on some days five or six, catalogs in the mail. I believe most people today use the catalog services for one reason -- convenience -- and not because they are consciously trying to avoid paying sales and use taxes.

We have seen increased usage of "800" toll-free telephone numbers, credit card promotions on television and through telephones, and mail-order catalogs in recent years. Direct marketing businesses now total approximately $150 billion annually and account for 14 percent of all retail sales. That percentage is expected to rise to 20 percent by 1990. It clearly is now a significant threat to our local merchants.

This is no longer an issue that can be left unresolved. I applaud the increased awareness in Congress that a national solution to this problem must be found. The National Governors' Association (NGA), National Association of Tax Administrators (NATA), National Conference of State Legislatures (NCSL) and the Multistate Tax Commission (MTC) have been working together to help craft federal legislation that will be acceptable to all concerned.

This is an issue that should not be dealt with on an individual state-by-state basis, as our Illinois legislature recommended last year. It can only be resolved with federal legislation that will set a nationwide standard for the collection of state use taxes in a fair and equitable way.

The ACIR and state groups worked together on legislation that was introduced last year by Rep. Jack Brooks -- legislation that was considered fair by opponents and proponents alike. As you know, Rep. Brooks has reintroduced his legislation this session.

The Brooks bill, H.R. 1891, includes an exemption from sales tax collection for companies that have total national sales below $12.5 million and sets a $500,000 sales threshold for each state. The $12.5 million de minimus provision would apply to less than 100 (2 percent) of all mail order firms. Rep. Dorgan's bill, H.R. 1242 sets the national de minimus at $5 million. The NGA supports either of these de minimus provisions with a threshold for each state.

Mr. Chairman, it is my understanding that Rep. Dorgan and his staff have indicated that his bill is a vehicle for action and that the specific language of H.R. 1242 is negotiable. Specifically, we prefer that the simple and single test of nexus as defined in H.R. 1891 be included and/or substituted for the five-faceted definition in H.R. 1242. We support the specific inclusion of "use taxes" in the definition as it is in Rep. Dorgan's bill.

Both bills would set a single tax rate for each state and would neither require collection of local sales tax unless the rate is common to all jurisdictions, thus eliminating the need for companies to keep track of thousands of local tax rates.

The hodgepodge of local taxing jurisdictions -- some say as many as 43,000 -- has been one of the main arguments against the collection of the tax by mail-order firms. More than 7,000 of these jurisdictions now have sales taxes. We are not interested in creating an undue burden on direct mail businesses and are seeking simplified administration for all parties.

In twenty-two states, local governments already receive a portion of any increase in state sales taxes and would benefit from this legislation. We would support a provision that a minimum local sales tax rate could be included in the single state rate so long as this minimum rate was uniform in all geographic areas. However, we cannot support the inclusion of more than 7,000 separate non-uniform local taxes as a part of the national legislation.

We also are concerned with the provision in H.R. 1242 that would require retailers to file information returns with the Internal Revenue Service. Opposition to collection of the sales tax is already vocal; any added reporting requirements would only increase that opposition. We currently have excellent working relations with the IRS for shared information on all relevant data. We want the support of IRS and would consider their suggestions for this provision.

The very fact that this hearing is being held is encouraging to all those who have been working toward a solution to this issue. We look forward to working with Rep. Dorgan and Rep. Brooks and all those who are sponsoring this legislation. I am sure that we can reach an equitable and successful solution to the problems caused by National Bellas Hess.

I urge you to consider this issue in the 100th Congress. At a time when states are being asked to shoulder more of the costs for programs, we cannot ignore the loss in revenue from decisions such as National Bellas Hess. The current situation is unfair to everyone -- the customers who pay, the local merchants who must compete at a cost disadvantage, and, ultimately, to the mail-order businesses themselves, for without federal legislation they eventually will face an unending hodgepodge of state and local laws and litigation.

What we face here, Mr. Chairman and members of the Congress, is a growing loss of legitimate state revenue, legitimately imposed, because of changes in the way retail sales occur in America.

To sum it up in a phrase that all of you hear repeatedly, "We don't have a level playing field." Here, there is no level selling field between the neighborhood merchant and the City of Chicago, or the small town merchant in a suburban or rural area of Illinois, or any other state, and those who come into our states by means of the mails or by television and don't charge the same price because they don't have to collect the sales tax. There will never be a completely level playing field between the merchant who must maintain a physical presence, hire employees, and participate in the local community, and an out-of-state solicitor. We understand that. We are not asking for absolute parity when it cannot be achieved because of these overhead costs.

In the name of equity, the sales tax differential between the out-of-state solicitors and those who have been Main Street, neighborhood fixtures in America for a long, long time should not be tolerated any longer.

Mr. Chairman, the Governors of every member of this subcommittee strongly support corrective legislation on mail-order sales taxes. We will be glad to work with each of you to make this a reality.

Thank you, Mr. Chairman.

Mr. DORGAN. Governor, thank you very much for an excellent statement and let me just ask a couple of brief questions and then call on other members of the subcommittee.

You were not here for some questions recently by Mr. Gregg. Let me ask, how would you respond to the kind of question posed by Mr. Gregg about the constitutionality?

I think the allegation is made that this is patently unconstitutional, that is attempting to do what this bill or the Brooks bill would attempt to do with respect to the *National Bellas Hess* case.

Second, even if this were doable, does this not create a situation whereas Mr. Gregg said 6,700 potential auditors flying in their private jets would come to Chicago to begin auditing a poor mail order firm.

How do you respond to those kinds of criticisms of this approach?

Governor THOMPSON. I am not sure that the sight of 6,000 auditors coming to Chicago would be subject to criticism. The tourist attractions in my State are many.

Let me go in reverse order, if I can. While it has been some time since I read *National Bellas Hess*, my recollection of the reading of that opinion is that the opinion rested specifically upon commerce clause grounds and not on due process grounds.

And it is within the function of this body to define sufficient nexus in commerce clause terms. I would find it hard to believe that the Supreme Court would overturn a determination by this body of what you found sufficiently acceptable so that the interstate commerce could be burdened.

In fact, if you pass the bill, you are saying specifically we allow this burden on interstate commerce.

To the extent that due process questions still remain, I am of the opinion, though, of course, I could be wrong, that the act of sending goods into a State or of soliciting business in the State by the mailing of a catalog or the beaming of a television signal or a radio signal into the State would be sufficient nexus for due process grounds, at least for the obligation to collect the sales or use tax.

If the Congress or the States themselves were to attempt to go further and impose other less related burdens upon out of State retailers, then the issue of nexus and what constitutes nexus for due process purposes might be a more difficult one.

But simply for the purpose of collecting the tax in the same manner that instate retailers collect the tax, I think this Congress can constitutionally define nexus.

I also believe that the Governors are quite willing to work with members of the committee and with the various sponsors of the bills to ensure that this is not the nose under the camel's tent.

We do not have any interest in that. I believe a bill could be fashioned to remove the objections of my friend, Mr. Chapoton, and to make sure that we are not trying to burden the out of State retailers.

We simply want, as I said, to level the playing field and I believe there are ways we can do that without subjecting out of State firms to burdensome requirements.

Mr. DORGAN. Well, Governor, let me say that I share your concern and your interest. It seems to me that if a mail order firm decides it wants to take advantage of the market in New Hamp-

shire and do business in New Hampshire that it ought to also be responsible for complying with essentially the same tax laws as the Main Street business in New Hampshire complies.

I think that is the issue here and I do not think any of us are interested in, as you describe it, the nose under the tent approach here.

It is a very simple attempt to describe nexus. It may be done better than this and there may be suggestions out there that accomplish it in a much more effective way.

But I do not think there is any intent on anybody's part to unleash a barrage of auditors across America, to foist upon legitimate business the kinds of nightmares that some have suggested.

I think it is a very simple, straightforward question, should we give the States the authority and the opportunity to level a sales and use tax collection responsibility on those who are doing business in the State by a television beam or by direct mail sales catalogs. That is what I think the issue is.

Governor, I want to thank you for your excellent testimony. Mr. McGrath?

(Mr. McGRATH. Thank you, Mr. Chairman. Welcome, Governor.

Governor THOMPSON. Thank you, sir.

Mr. McGRATH. In the third reason why you think that this bill would be beneficial, that of continuing the local sharing of voluntary efforts in the local community, I do not think you are suggesting that this kind of marketing that we see over television or through the mail or whatever, in an ever increasing amount, is going to become less because of this bill.

Governor THOMPSON. No, sir.

Mr. McGRATH. I share that with you. I think that when you can shop by pressing your television, I think you are probably going to do that.

The question I had for Secretary Chapoton was regarding the extension of this bill to local jurisdictions. Where I come from in New York, the State collects a 4 percent sales tax. The local jurisdiction I live in has a 4½ percent tax.

We seem to be a little bit confused as to whether or not this bill or Jack Brooks' bill allows for a local jurisdiction to collect the minimum of any of jurisdictions within the State added to the State base sales tax.

I am wondering whether or not the Governors' Association had any position on whether or not this bill should be extended to the local jurisdiction's ability to collect the sales tax?

Governor THOMPSON. It is the position of the National Governors' Association, as I understand it, to oppose any portion of the bill which would open up out-of-State retailers to the possibility of complying with thousands of individual local sales tax requirements on the grounds that simply—were the bill to do that—it would not pass the Congress.

But, we recognize political realities and we recognize that the same difficulties on revenue sharing between the States and the Federal Government exists between the States and local units of government. They are no longer our step children as they were in Victorian times.

They are our partners and we believe that working together with representatives of local government we could work out arrangements whereby local governments could share revenue. That happens by operation of law in some States, but not all.

In my own State, for example, we just received a report from a blue ribbon task force on streamlined revenue which recommends that all local sales taxes be collapsed into a single uniform rate, collected by the State and remitted to local governments.

Our legislature will be considering that idea at this session. I do not see any reason why the States and the local jurisdictions working together could not come to some sort of partnership understanding about how revenues might be collected or shared.

Mr. MCGRATH. I think you recognize the political reality of this and the administrative nightmare that this might generate.

But at the same time, once again, being the good politician that you are, you recognize that without the support of county executives and mayors and whatever, this thing does not have a snowball's chance in hell of passing.

Governor THOMPSON. Right.

Mr. MCGRATH. Thank you.

Mr. DORGAN. Mr. Gregg.

Mr. GREGG. I have to admit that if 6,700 revenue agents arrived in Chicago, they would probably be openly and enthusiastically received.

However, if they arrived in Peterborough, N.H., the home of Brookstone, which does not even own a motel, and they all arrived on the same day, that would be difficult on the townspeople, to say nothing of Brookstone.

I want to get to your last point, which was the third point, where you said that you felt that the mail order business was, because of its rate of growth, having an impact on Main Street merchandising in America and you thought that this was an atmosphere that was unfortunate. Is that a proper characterization?

Governor THOMPSON. I guess I am looking more into the future than at the present with the growing market share being captured by not only mail order houses, but at the proliferation of catalogs. And many of them are printed in the State of Illinois, I might say, so this is not an unmixed blessing, this burden that I carry as a co-lead Governor on this issue.

Looking at the state of the United States of America at the turn of the century and beyond and projecting market share by radio, television and catalog sales, I worry about the viability of Main Street retailing and worry then about the consequences of that for what we now accept as a good partnership between those merchants and volunteer and philanthropic efforts in the community.

Mr. GREGG. Is not the logical extension, though, of that position, were it adopted by a majority of members of the State legislature, that they could structure the sales tax in such a way as to basically foreclose competition from the outside mail order retailer, especially that small retail mail order house, which is not going to have the capacity—the mail order house that is maybe doing dresses or, I do not know, novelty items in the less than $5 to $10 million-range—and are not going to be able to keep up with 46 States' regulatory activity of them.

Thus, if a State wants to follow the idea that they want to protect their local retailers for the good and sound reasons that you have outlined, which is that it is maintained downtown quite often and it is kind of a quality of life issue, they will be able to use the taxing authority, especially the sales tax authority, to close out competition.

Governor THOMPSON. Congressman, I do not believe that that would necessarily—I do not believe that that would result for these reasons:

First, by this bill, we are not asking that you protect our local merchants. We are simply asking that you remove a barrier that has been erected by the Supreme Court decision in *Bellas Hess,* which gives out-of-State retailers a price advantage through the cost of the sales tax which they should not have.

They will still continue to have a significant advantage over in-State retailers by the inherent nature of their business. It is cheaper to do business that way than by maintaining a traditional retail structure.

The Congress cannot do anything about that. I cannot do anything about that. I do not want to do anything about that.

Second, while direct mail order houses, catalogue, radio or television, are continuing to capture greater market share, traditional retailing is responding in other ways.

And you are seeing, in many instances, especially with large in-state retailers, blended business operations.

A traditional retailer may retain a flagship store and a fleet of suburban stores in malls and may also have its own mail order business.

So, they are trying to protect themselves by taking on at least some aspects of what the competition is doing and that trend will continue as well, though that does little for the neighborhood or rural merchants who cannot reach that level of activity.

Since we are asking congressional permission to burden interstate commerce by the collection of the tax, Congress can set whatever limitations it wants on that request of ours. By your use of the de minimis rule you can protect the smaller mail order or radio or television merchants from any assertion of authority of the kind that you suggest might occur in the legislature.

And, finally, I think legislatures are quite hemmed in by other constitutional restrictions on attempts to unequally treat persons in like circumstances and I do not think efforts to discriminately tax against out-of-State business would get very far.

Mr. GREGG. Do you feel that States should have the preemptive right here or should municipalities also have the right to collect their sales tax?

Governor THOMPSON. Frankly, I do not know how you draw a bill that allows municipalities to directly collect the sales tax when you have so many thousands of jurisdictions.

I think some accommodation will have to be made where the State, in effect, acts as the agent for local governments and structure some kind of sharing arrangement with local governments in sales taxes collected to avoid that complication.

Mr. GREGG. Well, do you not immediately create a serious constitutional problem right there if you have the State collecting for the

municipalities, rebating to the municipalities, where you have municipalities that do not have a tax and some municipalities that do?

And you have got the person whose taxes are being collected coming from one municipality and you may have that tax revenue going back to another municipality?

I mean, you——

Governor THOMPSON. Suggestions like——

Mr. GREGG. You open a whole new constitutional can of worms.

Governor THOMPSON. Suggestions like that are constantly being made in my legislature from poor taxing districts to share the wealth with taxing districts supported almost entirely by sales tax revenues, for example, there is a shopping mall in one part of my state that draws customers from a wide area.

That jurisdiction in which the shopping mall is located can get along quite nicely on just sales taxes. It does not need to impose very high real estate taxes and other taxes.

The others are asking for a share in that and no constitutional objections have been raised to that and I am hard pressed to think of what the constitutional objection might be.

Mr. GREGG. Well, you have got the sales tax being grossed up. The State sales is being grossed up by a municipal tax now, so that the retailer in the town that does not have the municipal tax is put at a clear, constant, competitive advantage to the mail order house because of the fact that the taxes being collected at the State level and being rebated in a manner which has no relationship to where the taxes originated.

Governor THOMPSON. But if it comes in the form of a State tax imposed, if that is what has to be done, I do not see what the constitutional difficulty is.

Mr. GREGG. They are going to have to raise the State tax for everybody in the State, too.

Governor THOMPSON. Yes.

Mr. GREGG. Because you are going to have to have the State take over the municipal tax.

Governor THOMPSON. Well, probably not to the extent that you foresee, but I do not see how that poses a constitutional question.

Chairman DORGAN. The time of the gentleman is expired.

Mr. Brown.

Mr. BROWN. Thank you, Mr. Chairman.

Governor, we particularly appreciate your coming. We are keenly aware of the mischief that can be created by a legislature in the absence of the Governor. [Laughter.]

Sometimes we even engage in that ourselves. Your time is appreciated and your viewpoints are appreciated.

I think we all understand the feeling of desiring equal treatment between retailers located in the State. Is it your thought or the Governor's thought that nationwide merchandisers should be subjected to licensing requirements as well?

Governor THOMPSON. No, sir.

Mr. BROWN. In advocating a congressional authority to levy a sales tax, you are not asking for the authority also to require licensing or product inspection——

Governor THOMPSON. No, sir.

Mr. BROWN [continuing]. Or permits to do business in the State?

Governor THOMPSON. No, sir.

Mr. BROWN. What about State income tax? Will this be an occasion for requiring the national merchandiser to pay State income tax?

Governor THOMPSON. I do not think so.

Mr. BROWN. Thank you. That is very helpful.

Mr. DORGAN. Mr. Vander Jagt.

Mr. VANDER JAGT. Thank you, Mr. Chairman.

It is a pleasure to welcome a good friend to the subcommittee.

Governor THOMPSON. Thank you, Congressman.

Mr. VANDER JAGT. Thank you for being here. We are honored with your presence and are helped by your testimony. I apologize for not hearing all of your statement. The third point which I did hear was characteristically perceptive and eloquent and opened up a vista that I had not thought about.

I do have a couple of questions. If we were to impose the tax collecting responsibility on nationwide merchandisers, some of the information I have seen indicates that the costs to them of the sales tax or use tax collected would be about 15 percent. Would there be any receptivity to reimbursing them for the cost of collection, which probably exceeds dramatically the cost of an instate retailer collecting the tax right at the cash register, if it is a level playing field that we are after?

Governor THOMPSON. Yes, I think the States would be obligated to treat out-of-State salesmen in terms of reimbursement at least equally with the level of in-State and to allow a collection fee.

Mr. VANDER JAGT. But if it could be proven, and I do not know if it can, but if it could be proven that the cost to the out-of-State collector exceeded dramatically the cost to the in-State collector, could there be a differential in the reimbursement of the costs?

Governor THOMPSON. I suppose that is possible, Congressman Vander Jagt, but I would doubt very seriously that the costs of collection, especially under a simple bill that does no more than require a retailer to comply with the laws of those States which have sales taxes which are less than 50 in number would be dramatically above those of the in-State collector.

Mr. VANDER JAGT. The bill confronts a number of challenges and problems, although I think everyone is probably in sympathy with the view that a tax that is owed ought to be collected. Has any thought been given or any exploration made by the Governors' Association to any alternative way of collecting the tax in the State? Is there any other way of doing it, utilizing the State income tax? Have any possibilities been explored as an alternative to imposing that tax collection burden on an out-of-state merchandiser?

Governor THOMPSON. Well, it seems to me that without giving up entirely on the concept of the tax on the transaction, the only theoretical way would be to collect the tax from the ultimate purchaser. And that would cost far more, many millions of dollars than you would ever collect in tax, which is the reason why we do not attempt to collect the tax from the ultimate purchaser of an item from an in-state purchase, but rather make the instate vendor the collector. There is just no real way to do it.

Mr. VANDER JAGT. It has been explored and——

Governor THOMPSON. Oh, yes, and to go beyond that, to distribute the burden through the income tax or alternative tax is to simply give up on the philosophy of the sales tax.

Mr. VANDER JAGT. Well, thank you very much for being here. We appreciate it.

Governor THOMPSON. Thank you.

Mr. DORGAN. Governor, thank you very much for your appearance today.

Governor THOMPSON. Thank you, Mr. Chairman.

Mr. DORGAN. We will let the record remain open if the NGA wishes to submit additional material.

Next we will call on a panel comprised of representatives of the National Association of Tax Administrators, represented by S. Hunter Howard, Jr., first vice president, chairman, South Carolina State Tax Commission; accompanied by Leon Rothenberg, executive secretary of NATA; Heidi Heitkamp, tax commissioner of the State of North Dakota, representing the Multistate Tax Commission; and the Honorable David Nething, immediate past president, State Senator from North Dakota, immediate past president of the National Conference of State Legislatures.

I would like to welcome all of you here and indicate to you that we would include in the record a copy of your entire statement and I would hope that you would summarize your statement for the committee.

Let me first call on Mr. Howard, who is the chairman of the South Carolina State Tax Commission, representing the NATA.

Mr. Howard?

STATEMENT OF S. HUNTER HOWARD, JR., CHAIRMAN, SOUTH CAROLINA STATE TAX COMMISSION, AND FIRST VICE PRESIDENT, NATIONAL ASSOCIATION OF TAX ADMINISTRATORS; ACCOMPANIED BY LEON ROTHENBERG, EXECUTIVE SECRETARY

Mr. HOWARD. Thank you, Mr. Chairman.

As you said, I am Chairman of the South Carolina State Tax Commission, and I also serve as the first vice president of the National Association of Tax Administrators. NATA is a group that represents the State tax agencies of the 50 States and the problems in interstate sales tax evasion which H.R. 1242 addresses are a principal concern of our membership and we appreciate the opportunity to discuss these concerns with you today and the possible role of Federal assistance in that regard.

Before I begin, let me mention that your former colleague and my Governor, Carroll Campbell, asked me to extend to you his warmest personal regards. In our conversations, he mentioned that he was proud of the sensitivity and the responsiveness of this subcommittee on which you serve and that he shared our concerns in this regard and felt that this issue certainly needed to be addressed.

As you stated, I will summarize my remarks in the interest of time. The State tax agencies of the 45 States that do impose a sales tax strongly support the objectives of this bill. This legislation would negate the revenue loss which the States have incurred as a result of interstate sales tax evasion.

The Advisory Commission on Intergovernmental Relations established that in 1985 States lost more than $1 billion in revenues, and with the popularity of these merchandising techniques, this loss is expected to increase dramatically in the future.

Legislation of this type would also correct an unfair disadvantage which burdens local retailers who must collect this tax, whereby the out-of-State retailer can sell tax-free.

Sales taxes are a principal source of revenue for the States and are a vital support for public education. The States are concerned that with the rapid growth of interstate consumer purchases, which will seriously undermine this important source of revenue and the local businesses will suffer because of the tax advantage that their interstate competitors now enjoy.

National Bellas Hess deprived the States of their ability to require out-of-State vendors, with no physical presence in the State, to collect and remit taxes. This allowed these retailers to sell their products without collecting the tax, while the local retailer must add the tax to the price that they charge.

In addition, States are prohibited from obtaining information on mail order purchases from out-of-State retailers. Even if this information was available, the cost of collecting use taxes from the vast number of taxpayers would be impossible for the States to administer effectively a use tax on these consumers—a tax that is both very valid and very essential to the State tax systems.

With working two-income families, with the increase in cable television, toll-free numbers and higher sales tax rates, studies indicate that this industry is expected to grow significantly in the future.

Although we recognize that there are compliance considerations that have been mentioned here this morning, we feel that this bill, which imposes unified State rates and a sales threshold, could solve many of these concerns of businesses, particularly in light of the fact that some of the larger mail order firms, like Sears and Penneys, who have retail stores throughout the country, are now, and always have, collected and remitted these use taxes.

NATA joins with the Advisory Commission on Intergovernmental Relations, the National Governors' Association and the National Conference of State Legislatures in expressing support for this legislation to permit the States to require out-of-State vendors to collect sales and use taxes.

As Governor Thompson said, at a time when States are confronted by serious fiscal difficulties and when Federal financial assistance to the States and local governments are diminishing, effective State tax systems are vitally important to operations of State government.

Without legislation that addresses this problem, this vital source of State financing will be seriously threatened if the growth of interstate sales is not accompanied by a requirement that these taxes be collected on these transactions.

Thank you very much, Mr. Chairman. I would be happy to answer any questions.

[The statement of Mr. Howard follows:]

STATEMENT SUBMITTED BY

THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS

TO THE SUBCOMMITTEE ON SELECT REVENUE MEASURES,

HOUSE WAYS AND MEANS COMMITTEE HEARING ON

H.R. 1242, THE INTERSTATE SALES TAX COLLECTION ACT OF 1987

I am S. Hunter Howard, Jr., Chairman of the South Carolina Tax Commission. I also serve as First Vice President of the National Association of Tax Administrators. NATA is a service organization of the state tax agencies of the 50 state governments. The problems in interstate sales tax evasion which H.R. 1242 addresses are a principal concern of the state tax agencies. NATA appreciates the Committee's invitation to discuss with you these problems and the role of federal legislation in resolving them.

The tax agencies of the 45 states which impose sales taxes strongly support the objectives of H.R. 1242. The tax agencies have also expressed support for H.R. 1891 and S. 1099, bills which differ from H.R. 1242 in some detail, but which have the same objective. They also support the objectives of S. 639, another bill concerned with the taxation of mail order sales.

Legislation of this type would end the revenue loss which the states incur as a result of interstate sales tax evasion. These losses have been estimated by the Advisory Commission on Intergovermental Relations at more than $1 billion in 1985 and are growing rapidly as direct marketing operations expand and consumers become increasingly aware of the price advantage of purchasing ex-tax from out-of-state vendors. Legislation of this type would also end an unfair competitive disadvantage which burdens local retailers who must collect taxes on the sales they make while out-of-state retailers sell their goods tax free.

Because of the rapid growth in interstate consumer purchasing, the states are concerned that the sales tax--the principal source of revenue for many states--will be seriously undermined and that local business will suffer because of the tax advantage their interstate competitors now enjoy.

At NATA's 1986 Annual Meeting, the state tax agencies unanimously adopted a resolution expressing their concerns over interstate sales tax evasion and their support for federal legislation to address these problems. The resolution accompanies this statement. In brief form, this statement assembles information which may be helpful to this committee in evaluating the need for legislation such as H.R. 1242.

The *National Bellas Hess* Decision

The states' inability to collect taxes on interstate sales and the competitive disadvantage burdening local businesses arise from a 1967 U.S. Supreme Court decision, National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753, 87 S. Ct. 1389.

The Court, in a six-to-three decision, declared that Illinois could not require an out-of-state mail order company to collect sales and use taxes when its only activity in Illinois was the mailing of catalogs and advertising flyers and the delivery of ordered goods by mail or common carrier. In effect, the majority opinion ruled that Illinois could not require an out-of-state seller to collect sales and use taxes unless it had a physical presence in Illinois.

The dissenting opinion held that Illinois should not be deprived of its authority to require the out-of-state vendor to collect sales and use taxes. In the view of the dissenting judges, the out-of-state seller, like the local seller, derived benefits through the continuous solicitation and exploitation of the Illinois consumer market. They also found that the compliance burden on the out-of-state seller was no greater than the burden on mail order firms located in the state, and that excusing the out-of-state seller from the use tax obligation penalized retailers located in Illinois.

The majority opinion has been criticized by constitutional authorities both for its reasoning and its results. Supporters of the states' position agree with the dissenting opinion that a state's right to tax or to require the collection of a tax should not depend on the presence of solicitors in a taxing state. Instead, the connection between the out-of-state seller and the taxing state should be an economic rather than a physical relationship.

When the decision was delivered in 1967, state tax agencies expressed concern that it would stimulate the spread of interstate mail order retailers, with a consequent growth in sales tax evasion and state revenue loss. Now, with interstate marketing expanding rapidly, the growth has materialized far beyond expectations.

Impact on State Tax Administration

National Bellas Hess deprived the states of their ability to collect use taxes on sales by out-of-state vendors with no physical presence in the taxing state. The use tax, which complements the sales tax in each of the 45 states imposing such taxes, is critical to the effective operation of a sales tax. Use tax laws impose the same tax on a resident's purchases from retailers outside the state that sales tax laws impose on purchases from local retailers. If a state did not complement a sales tax with a use tax, it would discriminate against local business in favor of out-of-state business by inviting its residents, in effect, to avoid sales taxes through out-of-state purchases.

The National Bellas Hess decision restored the inequities the sales tax states sought to prevent by their universal adoption of use taxes. Before National Bellas Hess, the use tax like the sales tax was collected by the retailer--the use tax by the out-of-state retailer; the sales tax by the local retailer. Since the 1967 decision, the out-of-state retailer can sell his product without collecting a tax, while the local retailer must add the tax to the price of the item he charges. Thus, National Bellas Hess has destroyed the tax equity state laws established for local and out-of-state retailers.

The states cannot identify mail order purchases by resident consumers from retailers outside the state. Even if they could, the cost of collecting use tax from a vast number of non-reporting individuals would be prohibitive. In practical effect, the 1967 decision made it impossible for the states to administer effectively a consumer's tax that is both valid and essential to state tax systems.

The underlying principle of state excise taxation is that the tax must be collected from the seller. If the states cannot require mail order firms and other out-of-state vendors with no physical presence in the state to collect use taxes, then the taxes due on such transactions are not collectible. National Bellas Hess has created a situation where the states reluctantly have had to accept huge revenue losses, and local retailers have been significantly handicapped in their efforts to compete against their out-of-state counterparts.

The Growing Impact of *National Bellas Hess*

In 1967, the impact of National Bellas Hess on state revenues and on local business was disturbing but nevertheless relatively small. In the intervening years, that impact has grown explosively, as the sale of consumer goods through interstate marketing has emerged as a business phenomenon of the nineteen eighties, and sales tax rates have risen sharply in response to state budgetary needs.

Two decades ago, state and local sales taxes in excess of 5 percent were almost nonexistent. Now, they range to a high of more than 8 percent. In more than half of the states, combined rates are 6 percent or more, and in eleven states, they are 7 percent or more.

Interstate marketing has grown even more rapidly than sales tax rates. In 1967 mail order catalogs were virtually the only form of interstate consumer selling. Now, goods are sold across state lines through credit card companies, computers, 800 telephone numbers, television cable advertising, and home shopping clubs. Home shopping clubs have been described as a revolution in marketing. A large majority of firms engaged in this new form of interstate marketing charge sales and use taxes only in the states in which they are based. As these operations grow--and industry forecasters anticipate substantial growth--the state revenue loss and the local business disadvantage will both increase.

In addition to these new forms of interstate marketing, a growing number of national retail chains have made changes in their organizational structures designed to permit sales into states in which they have department stores without the collection of sales or use tax. A number of states are now in litigation over such activity by "Bloomingdales-By-Mail." Despite the use of the Bloomingdales name and certain business practices which relate to local business operations, the national retail chain's mail order facility has asserted that it is a separate entity and thus need not collect sales or use taxes on sales into states in which the chain has retail outlets.

The states are seeking to halt this practice through litigation. If they are not successful, only federal legislation would prevent other national chains from establishing mail order facilities which would engage in similar practices. The state revenue loss from such operations would be enormous.

The Proposed Legislation Will Facilitate Compliance

Each of three bills which have thus far been introduced in this session to correct the National Bellas Hess decision (H.R. 1242, H.R. 1891, and S. 1099) contain provisions which would simplify the out-of-state vendor's compliance with federal law. These provisions include a uniform state-local tax which would be paid to the state only, and a sales threshold (a de minimis rule) which would relieve small out-of-state vendors from the sales and use tax collection requirement. They would also limit the payment of taxes to once a calendar quarter and would bar any state requirements for geographical accounting. Local government sales taxes would be included in the payment to the state only when they were statewide and both the rate and base of the local taxes were uniform.

Under the proposed legislation, the compliance requirements for out-of-state sellers would correspond closely to those observed by local sellers. In fact, the bill's requirement that the out-of-state vendor remit taxes only once a calendar quarter imposes a lesser compliance burden than is imposed on local vendors who report on a monthly or more

frequent basis in most states. The requirement thus provides significant benefits to the out-of-state vendor by permitting them to retain and use sales and use tax collections for a much longer period than is permitted local retailers.

Nor would differences in the base of sales tax laws create any significant problems for mail order firms. Apart from food, non-prescription drugs, magazines and clothing (and this in only a few states), the goods sold by general merchandising mail order firms are almost entirely taxable. Such vendors need examine the state's list of taxables and the tax rate once to learn which of the goods it sells, if any, are exempt, and the tax to remit. Thereafter, the state would notify the vendor of any legislative changes in the list of taxables or the tax rate. Mail order vendors of specialty items--books, holiday goods, small special appliances--would have no problem once the taxable status of the goods they sell was determined.

It is important to note that mail order firms, such as Sears and J.C. Penney's, with retail outlets throughout the nation, have always collected and remitted use taxes in the manner prescribed by the proposed legislation. The rapidly growing TV home shopping networks differ in their sales tax collection practice. But most of the firms report that, except for home state sales, they do not add sales taxes to the price of the goods they sell.

The compliance records of the interstate companies now collecting use taxes leave no doubt that the proposed legislation is both feasible and necessary. If federal legislation does not put all business on an equal sales tax footing, local retailers, the relatively few interstate retailers who collect sales taxes, and their customers will be compelled to bear an ever-increasing burden.

Precedents for Federal Legislation

The problems arising from the National Bellas Hess decision are wholly federal in origin in that they result from interstate activity which the states cannot control under existing law. There are precedents for congressional action to assist the states in resolving interstate problems which exceed their jurisdictional authority.

Congress has assisted the states by enacting legislation to curb cigarette tax evasion by mail order (15 USC sec. 375-378) and by transportation across state lines (18 USC sec. 2341-2346). These laws halted forms of state tax evasion which the states could not address because of the interstate character of the evasion. Congress has also made the transportation of gambling devices accross state lines a federal crime (15 USC sec. 1171-1178), and it declared that the regulation of insurance was a state responsibility in 15 USC sec. 1011-1015. Also, to aid the states in addressing specific problems, Congress has enacted laws related to the interstate movement of stolen property, wagering information and persons seeking to avoid prosecution.

These are a few examples of Congress' recognition that state boundaries and limited state jurisdiction create problems which can be resolved only by federal action. The need to curb interstate sales tax evasion and protect state revenues fits into this category.

Summary

NATA joins with the Advisory Commission on Intergovernmental Relations, the National Governors' Association, and the National Conference of State Legislatures in expressing support for expanding state authority to permit states to require out-of-state vendors to collect sales and use taxes. At a time when many states are confronted by serious fiscal difficulties and when federal financial assistance to state and local governments is being diminished, effective state tax systems are critical to the operation of state government. Sales tax revenue accounts for one-third of state tax collections. Without legislation that addresses this problem, this vital source of state financing will be seriously threatened if the growth in mail order sales is not accompanied by a requirement that state sales and use taxes be collected on all such sales, and not solely on sales by local business.

RESOLUTION UNANIMOUSLY ADOPTED AT THE FIFTY-FOURTH ANNUAL MEETING OF THE NATIONAL ASSOCIATION OF TAX ADMINISTRATORS, HELD IN WASHINGTON, D.C., JUNE 29 - JULY 2, 1986

TWELVE

WHEREAS, Congressman Brooks has introduced H.R. 5021, a bill to authorize state sales taxes on interstate sales when the destination of the sale is in the taxing state and the vendor is engaged in the regular or systematic solicitation of sales in that state, and

WHEREAS, H.R. 5021 embodies the principles contained in the model legislation NATA adopted at its 1985 Annual Meeting, and

WHEREAS, the continuing growth of interstate sales by mail order and other companies results in a great competitive disadvantage for local business and in a state and local revenue loss now estimated at more than $1.5 billion annually, and

WHEREAS, the further growth in untaxed interstate sales will seriously erode the states' ability to administer and collect sales taxes, their principal source of revenue, now, therefore, be it

Resolved, that the National Association of Tax Administrators endorse H.R. 5021 and respectfully recommend to Congress that it consider and enact this legislation in order to end the states' huge revenue losses and remove the competitive disadvantage now burdening local business, and be it further

Resolved, that the National Association of Tax Administrators express its appreciation to Congressman Brooks for introducing this important legislation.

Mr. DORGAN. Mr. Howard, thank you very much. We will hold questions until the panel has made its presentation in its entirety.

Next we will call on Heidi Heitkamp, tax commissioner of North Dakota, appearing on behalf of the Multistate Tax Commission.

Heidi, it is a pleasure to have you in Washington and we welcome you to the committee. We will be glad to hear your testimony.

STATEMENT OF HEIDI HEITKAMP, TAX COMMISSIONER, STATE OF NORTH DAKOTA, ON BEHALF OF THE MULTISTATE TAX COMMISSION

Ms. HEITKAMP. Thank you, Congressman.

Mr. Chairman, members of the subcommittee, my name is Heidi Heitkamp. I am tax commissioner for the State of North Dakota, and today I am representing the Multistate Tax Commission (MTC).

I appear before you on behalf of our 29 members and associate members of the MTC. First, I would like to thank you on behalf of the MTC for the opportunity to testify, and I would also like to thank you on behalf of our Governor, Governor Sinner, who is cochair with Governor Thompson of the NGA group to review and promote Federal legislation on the *Bellas Hess* problem.

MTC's position on *Bellas Hess* legislation basically grows out of the concern for two issues: One, the revenue issue, which obviously all State revenue agencies are concerned about; and the second issue is that of unfair competition. You have heard a lot today about the numbers and how much revenue is lost and I will give you maybe a little more personal perspective on the unfair competition issue.

I recently became tax commissioner in December and had the opportunity at that point in time to go out and review with the people of North Dakota legislation that had recently passed a special session. And in almost every small town that we stopped in to talk about the legislation, I was approached on this problem, and the problem basically is twofold: the question of competition, how can we compete at a 5 percent and what soon will be a 5.5 percent sales tax rate, how can we compete with entities that do not have to charge this; and the second problem that was presented to me in terms of the competition was the problem of consumers using the retail store to review products and items that they may be interested in purchasing and then proceeding to purchase them through the mail order outlets.

So the competition question is very real and it is very real in the State of North Dakota. It is not unique to North Dakota, as Governor Thompson has said, it is something that every member of the MTC has expressed concerns.

I do want to give you some background on what we call the MTC voluntary project. The MTC has put together not only with member States, but also with States from outside of our membership, a working group or a task force to promote voluntary compliance with use tax collection. It has been fairly successful, but there still is a consensus among the States that that voluntary effort will not take care of the problem and that we need to proceed to have

Congress review the interstate commerce clause questions that are presented in the bill.

I will not belabor the point any more. You have had sufficient testimony on the revenue amounts.

Thank you, Mr. Chairman.

[The statement of Ms. Heitkamp follows:]

Statement of

Heidi Heitkamp,
North Dakota State Tax Commissioner

on behalf of
Multistate Tax Commission

I am Heidi Heitkamp, Tax Commissioner for the State of North Dakota and a member of the Multistate Tax Commission (MTC). I appear before you today on behalf of the 29 member and associate member states of the MTC. Briefly stated, the purpose of the MTC is to bring further uniformity and compatibility to the tax laws of the states insofar as those laws affect multistate business; to provide a forum for business and states to work out tax problems; to study and make recommendations with respect to all taxes affecting multistate businesses; and to assist in protecting the fiscal and political integrity of the states. I appreciate the opportunity to appear before you today to offer testimony concerning H.R. 1242, the "Interstate Sales Tax Collection Act of 1987."

First, I would like to commend the Subcommittee, and Representative Dorgan, for focusing congressional attention on this issue, which is a very important one for the states. State tax administrators are concerned about untaxed mail order sales not only because of the adverse revenue impact the states are experiencing, but also because we are concerned that our Main Street retailers remain healthy, vigorous components of the economic structure.

You are no doubt aware of the legal roots of the problem. In a 1967 decision, National Bellas Hess v. Illinois Department of Revenue, the U.S. Supreme Court ended the obligation of out-of-state direct marketers and border sellers to collect sales (or "use") taxes from buyers and remit the revenue to the home state of the purchaser.

I would like to take just a moment to define what a "use" tax is. Most of the 46 states (including the District of Columbia) which impose a sales tax on in-state purchases also employ a complimentary "use" tax on out-of-state purchases by their residents. In theory, the 1967 Supreme Court decision did not end the obligation of consumers to remit to their home state "use" taxes on out-of-state purchases; the decision simply ended the requirement that out-of-state businesses collect the tax and remit it to the purchaser's home state. In reality, however, the practical effect has been that, although consumers who buy from out-of-state businesses are legally liable for "use" taxes, the cost of collection from all but the largest buyers would far exceed the revenue recovered. Simply put, the Supreme Court said we can continue to impose a sales tax on mail order sales made by out-of-state companies, but we cannot require the companies to collect and remit the tax. We must rely on consumers to voluntarily pay the tax to their home state revenue department.

That is the problem that the states are faced with today. The federal Advisory Commission on Intergovernmental Relations (ACIR) estimates that the states are losing as much as $1.5 billion in revenue each year on untaxed mail order sales. In North Dakota, it is estimated that we are losing almost $10 million in revenue each year. The impact of this revenue loss is severe, particularly in light of North Dakota's precarious fiscal condition.

Out-of-state businesses threaten the future of the sales tax, which is the second most important state revenue source, accounting for one of every four state tax dollars. Fourteen states rely on sales taxes for more than 40 percent of their revenues. Seven states depend on sales taxes for more than half their revenues. Furthermore, states have been increasing their dependence on sales taxes. From 1974 to 1984, the median state sales tax rose from 3.8 percent to 4.4 percent. The increasing popularity of direct marketers and border sellers is eroding the sales-tax base. ACIR estimates that 38 of the 46 sales-tax states lost at least $10 million each in sales-tax revenues in 1985. An ACIR Fall 1984 survey of state tax officials found that

30 of 35 administrators said they had lost "significant" tax revenues because of mail-order sales.

The revenue impact of the 1967 Supreme Court decision has been exacerbated by the explosive growth in mail order sales. Congressional Quarterly recently noted that "consumers have gone on a mail order shopping spree, buying everything from expensive home computers and telephone equipment to a vast array of clothing, kitchen supplies, household tools and other items sold by such companies as American Express, Sharper Image, Brookstone and Lillian Vernon."

Direct marketers -- whose solicitation methods include mail-order catalogs, telephone selling, direct-response commercials, advertising inserts, computer shopping and other high tech methods -- run a $150 billion a year business accounting for 14 percent of all retail sales. By 1990, direct marketers are expected to control at least 20 percent of retail sales, according to the Direct Marketing Association.

Changing technology will make mail order shopping more convenient than ever, with personal computers and cable television providing direct links between buyers and sellers. BusinessWeek, in a December, 1986, report on "home shopping," predicted that "within three years, almost anyone with a telephone and a television set will be able to shop at home." Home shopping sales hit $450 million in 1986 and according to industry analyst Paul Kagan Associates, sales could pass $2 billion in 1987. More than 50 million people -- more than half of all homes with television -- will be able to tune in to a home shopping program by late this year. The president of a company about to launch a cable television shopping program said the company will provide consumers with a "sort of electronic mall" by combining the products of more than 100 catalogs in one program.

In addition to cable television's home shopping programs and computer shopping, major national retailers, such as Bloomingdale's, have established mail order businesses by setting up a separate corporate identity designed to permit interstate sales without the collection of the use tax.

The unfair advantage for untaxed, out-of-state firms threatens the future of Main Street America. Sales by out-of-state firms are rising faster than those of traditional retailers. According to industry analyst Maxwell Sroge, first-quarter 1985 mail-order catalog sales increased 19 percent over the same period in 1984. Traditional retail sales rose only 5.7 percent in the same period. Says Jo-Von Tucker, a New York consultant for 16 catalog firms, "The biggest surge in mail-order growth usually comes when retail sales are weaker." An industry consulting firm reported in May 1985 that 74 percent of Americans had purchased by catalog in the previous year and concluded, "There is a lot of room for direct-marketing growth."

Economists Ronald C. Fisher of Michigan State and John Mikesell of Indiana University estimate that a 1 percent increase in a sales tax rate may reduce local retail sales 6 percent, as consumers find ways to beat the tax. These sales losses to Main Street merchants are gains for direct marketers and border sellers. Thus, retailers and state tax administrators are caught in a vicious cycle: declining in-state retail sales force sales tax rates up to make up for reduced revenue. Higher sales tax rates chase more customers to out-of-state firms, who have a price advantage equal to the tax rate of the customer's home state. ACIR concludes that the "virtual tax immunity" of out-of-state firms sends customers to direct marketers and border sellers.

The tax advantage which direct marketers enjoy is not lost on the industry. While flipping through a magazine recently, I noticed an advertisement for Silver Wallpaper, Inc. In their ad, the store encourages consumers to "Shop in Your Neighborhood; Write Down Pattern, Number/Book; Then Call." In addition to announcing "free delivery," the store highlights the fact that if you live outside of Pennsylvania, you don't have to pay sales tax. What I hear from local merchants across the State, and I know my colleagues hear similar stories from their local merchants, is that they simply cannot compete with out-of-state direct marketers. What I hear is that consumers come into their stores, decide on the merchandise they want, and then purchase the merchandise tax free from an out-of-state direct marketer. This is particularly true in the "big ticket" industries such as electronics equipment, furniture, etc., where the sales tax savings can be significant.

The Dallas Times Herald, in its October 16, 1986 edition, reported on why more and more consumers are turning to direct marketers and other out-of-state businesses for their purchases. Said the Times Herald: "When the shopping urge hits Brian Graifman of New York, he doesn't head for a store or thumb through the Yellow Pages. Instead, he consults a stack of mail-order catalogs, whips out his credit card, dials some toll free numbers and has merchandise delivered to his door tax-free." Among Graifman's purchases through mail order are "big ticket items" such as a videocassette recorder, a cordless telephone, and stereo equipment. "Mail order is more convenient," said Graifman. "You eliminate the middle man. If you order out-of-state, you don't pay [sales] taxes ..."

The Dallas Times Herald speculated that the tax-free appeal of mail-order merchandise may increase with the recent enactment of the tax overhaul measure. The new law ends the deductibility of state sales tax on federal income tax returns. According to the report, "some experts expect more consumers -- to avoid paying a levy they can no longer deduct -- to be lured to the booming mail-order business."

In North Dakota we have 26,000 retailers, all of whom collect the 5 percent (5.5 percent as of July 1) state sales tax. The untaxed sales transactions of their out-of-state competitors creates an unfair price advantage equal to the 5 percent tax rate of North Dakota whenever purchases are mailed or delivered into the State. Said Art Wheeler, president of the North Dakota Retail Association, "If direct marketers continue to replace the American storefront, our nation's unemployment levels will know no bounds, for there may not be Main Street employers to provide jobs and livable incomes to wage earners, our neighbors and friends."

The North Dakota 49th Legislative Assembly adopted a formal request of Congress to adopt legislation which would allow states to require out-of-state companies to collect and remit sales tax on all transactions. I am here today on behalf not only of the MTC, but also on behalf of North Dakota and nationwide Main Street retailers who cannot survive the competitive advantage enjoyed by mail order companies.

As you may know, the Multistate Tax Commission supports H.R. 1891, introduced by Representative Jack Brooks. H.R. 1891, the "Equity in Interstate Competition Act of 1987," is similar in purpose to Representative Dorgan's bill, H.R. 1242. Both bills would close the sales-tax loophole which benefits out-of-state businesses. We look forward to working with the Committee to pass a bill which will restore the integrity of state sales taxes and eliminate the competitive advantage out-of-state businesses enjoy over our Main Street retailers.

Thank you.

Mr. DORGAN. Thank you very much, Heidi.

Next we will hear from Senator David Nething, from North Dakota. He is the past president of the National Conference of State Legislatures, and I know that you have worked on this issue in the past and have been involved in this issue, as has the State Tax Commissioner of North Dakota. Dave, we welcome you to Washington and welcome you especially to the committee.

STATEMENT OF HON. DAVID E. NETHING, STATE SENATOR, STATE OF NORTH DAKOTA, AND IMMEDIATE PAST PRESIDENT, NATIONAL CONFERENCE OF STATE LEGISLATURES

Mr. NETHING. Thank you very much, Mr. Chairman and committee members. My name is David Nething and I am a member of the North Dakota State Senate. I am immediate past president of the National Conference of State Legislatures and it is on their behalf that I appear before you today.

I am also a member of the U.S. Advisory Commission on Intergovernmental Relations, which more than a year ago recommended correcting the 20-year-old *Bellas Hess* decision, and I hope you have had the opportunity of its research.

The central issue is whether States should be permitted to require out-of-State companies to collect a sales or use tax when these companies target the citizens of these States as a market for their goods. NCSL, which represents the Nation's 50 State legislatures, has for several years urged the adoption of this legislation.

I want to give you four reasons that support the conclusion that Federal legislation is needed. First of all, changing markets: More than ever, consumers are purchasing tangible goods using the improved technologies in communications and transportation. Commercial enterprises have long known the cost savings that can result from centralization of distribution centers. With sophisticated technologies, these companies can take advantage of expanded markets without having a human agent in the field. The toll-free telephone call and express delivery service have replaced that person.

Basing taxable nexus upon the presence of a human agent in the taxing State was the primary distinction upon which the Supreme Court decided to forbid States from requiring tax collection by out-of-State companies. Even 20 years ago, the dissent in *National Bellas Hess* noted that the presence of a human agent was not "meaningfully distinguishable." Today, for purposes of taxation of out-of-State sales, such a distinction is truly obsolete. NCSL therefore applauds the goal of H.R. 1242, which adapts the law to these swift and pervasive changes in commerce.

Second, the need for equity in interstate sales competition is another important reason to approve legislation correcting *National Bellas Hess*. Two factors contribute to the competitive advantage for out-of-State sellers. They do not face the costs of compliance, and more importantly, consumers have an incentive to purchase from them, because cosumer believe they do not owe taxes on such purchases.

The merchants in my State act as an agent for the State in collecting a sales tax of 5.5 percent on items purchased from them.

Those merchants—large and small—face compliance costs. The owners of small businesses may have few employees and little knowledge of the tax laws, and yet they seek assistance and comply with the law. No substantial, practical reason exists for the company with national sales of more than $5 to $12 million, to be given this competitive advantage over our hometown merchant.

Improved, even-handed enforcement, is another way of increasing the fairness in our tax system, especially at a time when public sentiment strongly opposes new taxes. Full enforcement of the sales and use taxes can help provide States over $1.5 billion in needed revenue that is legally owed. The administration and Congress understand the need to increase the investment in collection and enforcement of taxes before giving consideration to new Federal taxes. We hope that this same understanding will carry over to assist us.

The National Conference of State Legislatures supports the objectives of this bill today, even though the argument has been made that by asking Congress for relief, the States lose some autonomy over their tax policies. The argument is without merit, because that autonomy has already been lost by the Supreme Court decision.

In spite of that Supreme Court decision, a number of State legislatures have acted in this area. Their purpose was both to alert Congress to the need and to have enabling legislation in place in the event that Congress will act favorably. However, our efforts are under a cloud of uncertainty. The legislatures of Nebraska and Arkansas, for instance, passed legislation to define nexus so as to require collection of the tax of mail order sales. The bills passed even though some legislators expected legal challenges. In Illinois, similar legislation was passed, but Governor Thompson vetoed it, explaining that the necessary action would have to be initiated not by the States but by Congress.

The reluctance of some Governors and legislatures to act on the *National Bellas Hess* matter is due to our uncertainty over the enforceability of such State legislation; however, we are not uncertain over the need for congressional action. Policy adopted by NCSL reflects the overwhelming opinion of legislatures that Federal legislation is called for in this area.

Another issue to address is one that may be raised by the local government groups: should legislation provide for a uniform State tax rate on out-of-State sales? We believe that the answer is yes. Municipalities will benefit from increased tax collections from out-of-State purchases; indeed, under the laws of several States, localities would automatically benefit from enhanced sales tax, and I believe there are 21 States where that would take place. However, we understand the likelihood of corrective legislation becoming a reality depends in part upon the simplicity of the measure. NCSL realizes that the question of burdening interstate commerce is one of degree. Therefore, we endorse the concept of a uniform tax rate within each State on out-of-State sales, as proposed in the bill of Congressman Dorgan and Congressman Brooks.

In closing, I want to commend the members of this committee, and particularly you, Congressman Dorgan, for your efforts in granting this issue a long overdue hearing. Fairness in interstate

commercial transactions and in tax administration can be enhanced by your efforts. NCSL stands ready to assist you in shaping legislation to correct *National Bellas Hess* and in working for its passage.

Thank you for your consideration. I would be happy to respond to questions.

[The statement of Senator Nething follows:]

Testimony of Senator David E. Nething, North Dakota Legislative Assembly

on behalf of the National Conference of State Legislatures

before the Select Revenue Committee of the House Committee on Ways and Means,

concerning The Interstate Sales Tax Collection Act of 1987 (H.R. 1242)

Wednesday, May 13, 1987

My name is David Nething. I am a member of the North Dakota State Senate, and I am immediate past president of the National Conference of State Legislatures, on whose behalf I appear before you today. I am also a member of the U.S. Advisory Commission on Intergovernmental Relations, which more than a year ago recommended correcting the twenty-year-old *National Bellas Hess* decision.

The central issue is whether states should be permitted to require out-of-state companies to collect sales or use taxes when these such companies target their citizens as a market for their goods. The National Conference of State Legislatures, which represents the nation's 50 state legislatures, has for several years urged the adoption of enabling legislation.

I will address four major reasons that support the conclusion that federal legislation is needed. First, technologies have made major changes in corporate marketing patterns and consumer buying habits; second, local community retailers are placed at a competitive disadvantage against those who use the state as a market but are not required to collect taxes; third, enforcement is increasingly seen as the fairest way to insure increased revenue without imposing new taxes; and fourth, the Supreme Court's decision means that the states must look to Congress for a solution to this problem.

Changing markets

More than ever, consumers are purchasing tangible goods using the improved technologies in communications and transportation. Commercial enterprises have long known the cost savings that can result from centralization of distribution centers. With sophisticated technologies, these companies can take advantage of expanded markets without having a human agent in the field. The toll-free telephone call and express delivery replace the salesman.

Basing taxable nexus upon the presence of a human agent in the taxing state was the primary distinction upon which the Supreme Court decided to forbid states from requiring tax collection by out-of-state companies. Even twenty years ago, the dissent in *National Bellas Hess* noted that the presence of a human agent was not "meaningfully distinguishable". Today, for purposes of taxation of out-of-state sales, such a distinction is truly obsolete. NCSL therefore applauds the goal of H.R. 1242, which adapts the law to these swift and pervasive changes in commerce.

Fairness in interstate competition

The need for equity in interstate sales competition is another important reason to approve legislation correcting *National Bellas Hess*. Two factors contribute to the competitive advantage for out-of-state sellers. They do not face the costs of compliance, and more importantly, consumers have an incentive to purchase from them, because they believe they do not owe taxes on such purchases.

The merchants in my state act as an agent for the state in collecting a sales tax of 5 1/2 % on items purchased from them. Those merchants--large and small--face compliance costs. The owners of small businesses may have few employees and little knowledge of the tax laws, and yet they seek assistance and comply with the law. No substantial, practical reason exists for the company with national sales of more than $5 - $12 million, to be given this competitive advantage over your hometown merchant.

The competitive edge in being an out-of-state merchant was noted recently in an article in the *Washington Post Sunday Magazine*, which told consumers how to save money on major purchases. [May 3, 1987]. Tip number 10 was, and I quote:

> "The rules for saving on deliveries and taxes are: Buy out of state from a store that has no branches in your state. Have the item delivered, and you'll avoid taxes. Just make sure the delivery charge isn't higher than the taxes you've saved."

The writer failed to inform the reader that even if the items are purchased in another state, taxes are due in the state of residence. The Supreme Court did not strike down the tax itself, but rather, it eliminated the only efficient mechanism of enforcement. Every state with a sales tax also has a compensating or "use" tax for such purchases.

Tax avoidance is not a fair element of competition.

Improved fairness through enforcement

Improved, even-handed enforcement is another way of increasing the fairness in our tax system, especially at a time when public sentiment strongly opposes new taxes. Full enforcement of the sales and use taxes can help provide states over $1.5 billion in needed revenue that is legally owed. The Administration and Congress understand the need to increase the investment in collection and enforcement of taxes before giving consideration to new federal taxes. We hope this understanding will carry over to assist states in this enforcement effort.

In spite of the widespread belief that the Tax Reform Act of 1986 created a windfall for some of the states, the reality was much different. Revenues did not miraculously blow in on the wind from Washington; they could come only as a result of an increase in the taxes to be paid by individuals at the state level. The state legislatures recognized this, and we had to look at the response to tax reform as we look at any tax increase: Is it needed? In North Dakota, as in many other states, tax increases have been required to maintain sound fiscal condition. Asking for a tax increase was especially painful when we knew that nearly four million dollars in taxes due North Dakota could not be collected because of the *National Bellas Hess* impediment.

Today I am asking you to continue to work to increase the fairness in the enforcement of our sales and use taxes by removing the impediment placed in our way by the Supreme Court decision.

Federalism and the need for congressional action

The National Conference of State Legislatures supports the objectives of the bill under consideration today, even though the argument has been made that by asking Congress for relief, the states lose some autonomy over their tax policies. The argument is without merit, because that autonomy was already limited by the Supreme Court decision.

In spite of the Supreme Court decision, a number of state legislatures have acted in this area. Their purpose has been both to alert Congress to the need and to have enabling state legislation in place in the event Congress acts favorably. However, our efforts are under a cloud of uncertainty. The legislatures of Nebraska and Arkansas, for instance, passed legislation to define nexus so as to require collection of the tax of mail order sales. The bills passed even though some legislators expected legal challenges. In Illinois, similar legislation was passed, but vetoed: Governor Thompson, who is our ally before Congress on this issue, felt that the necessary action would have to be initiated, not by the states, but by Congress.

The reluctance of some governors and legislatures to act on the *National Bellas Hess* matter is due to our uncertainty over the enforceability of such state legislation; however, we are *not* uncertain over the need for congressional action. Policy adopted by the National Conference of State Legislatures reflects the overwhelming opinion of the legislatures [illegible] is called for in this area.

Local sales taxes

Another issue to address is one that may be raised by local government groups: should legislation provide for a uniform state tax rate on out-of-state sales? NCSL believes the answer is "yes". Municipalities will benefit from increased tax collections from out-of-state purchases; indeed, under the laws of several states, localities would automatically benefit from enhanced sales tax revenues. However, we understand that the likelihood of corrective legislation becoming a reality depends in part upon the simplicity of the measure. NCSL realizes that the question of burdening interstate commerce is one of degree.

Therefore, NCSL endorses the concept of a uniform tax rate within each state on out-of-state sales, as proposed in the bills of Congressman Dorgan (H.R.1242) and Congressman Brooks (H.R. 1891).

Closing

In closing, I want to commend the members of this committee, and particularly Congressman Dorgan, for your efforts in granting this issue a long-overdue hearing. Fairness in interstate commercial transactions and in tax administration can be enhanced by your efforts. The National Conference of State Legislatures stands ready to assist in shaping legislation to correct *National Bellas Hess* and in working for its passage. Thank you for your consideration.

Mr. DORGAN. Senator Nething, thank you, and thanks to the entire panel.

Mr. Andrews will inquire.

Mr. ANDREWS. No questions, Mr. Chairman.

Mr. DORGAN. Mr. McGrath.

Mr. MCGRATH. Let me ask a couple of questions, if I might. Representations have been made here this morning that really no service is provided by a State for a mail order firm that is selling in the State. Heidi, perhaps you could describe to us, if a mail order seller is selling in North Dakota or New Hampshire or some other State, is there a service provided if that firm does not maintain a place of domicile, and does not have agents on the road? What is the issue here with service?

Ms. HEITKAMP. Congressman, certainly from the standpoint of the State there is a definite service that is provided to the direct marketers. Without education systems and without a viable economy that the State offers, there would be no market, without an ability to read the citizens could not go ahead and order things and not fill out their order blanks.

There is obviously, just by providing the market a very real benefit that is being provided to the direct marketers, and one benefit that was suggested by one of our Senators in a local hearing was the benefit of the garbage service to carry out all of the mail order catalogs that people had received, which apparently are stacking up in their homes, to just get rid of those products.

The other benefit that we look to is the collection benefit and the idea that there is an on-going warranty on many of these products that are located in the State and a benefit that the local merchants may provide in terms of warranty and fixing products that no longer are operative or operable under their warranty conditions, so obviously the States believe there is a very real benefit that is being provided to the direct marketers.

Mr. MCGRATH. Thank you very much.

Senator Nething, are you concerned about the issue raised by Congressman Gregg of this just being the forerunner of other problems, business licensing and so on? I believe Congressman Brown also raised the same issue, the nose under the tent, as Governor Thompson described it.

Mr. NETHING. I do not think it is a realistic concern. I think that most State legislators are very interested in providing the best competition that is available, and I do not think they want to go into a protectionist attitude. I think that this is something that—I know you folks deal with it here on a global basis, but I think to indicate that the States are going to go into a protectionism of their local retailers just will not cut the political mustard, because our constituents want to have the goods that are available, and that is the good competition for our retailer to confront and our constituents would not really tolerate the fact that we were to impose so many burdens that they would not have this source available to them. So I think it will govern itself and I think it is just a question of making sure that the local businessman does not have to sell at a 5 percent discount just in order to meet the price.

Mr. DORGAN. Mr. Howard and Mr. Rothenberg, what of the argument that has been made that this is really going to unleash a bar-

rage of auditors and represents an unfair situation for out-of-State sellers who may be confronted with overly aggressive enforcement techniques, et cetera?

Mr. HOWARD. As I understand the bill as it is written at the present time, they would only be involved with dealing with 46 tax entities and would not necessarily be involved with the 5,500 that we are talking about at one time under the way it is structured at the present time.

Mr. DORGAN. Mr. Howard, did you indicate that Carroll Campbell, the Governor of your State supports this type of legislation?

Mr. HOWARD. Yes, the Governor is very interested in this issue and certainly thinks it should be addressed.

Mr. DORGAN. Well, I hope that you will convey to him our best wishes. He did serve on the committee and on this subcommittee and I hope you will convey our best wishes to him.

Mr. DORGAN. If there are no further questions, we thank the panel for their appearance and thank you very much for the lengthy statements that contain a great deal of information for us.

The next panel will be a panel comprised of the National Association of Retail Dealers of America, James Goldberg, Washington counsel; Circuit City Stores, Inc., Robert M. Hausman, counsel; Georgetown Manor, represented by Joseph Chesnick, owner; Plunkett Furniture Co., John T. Plunkett, owner; and National Association of Retail Druggists, John Rector, general counsel, and vice president.

If the panel members would come forward and take your places, we would like to ask that the members of the panel summarize their statements for us. We will make the full statements of the panel members a part of the permanent record of the subcommittee, and we would ask that the statement that you provide us orally be a summary of that.

We would first call on James Goldberg, the National Association of Retail Dealers of America.

Mr. Goldberg, welcome.

STATEMENT OF JAMES M. GOLDBERG, WASHINGTON COUNSEL, NATIONAL ASSOCIATION OF RETAIL DEALERS OF AMERICA, INC.

Mr. GOLDBERG. Thank you, Mr. Chairman.

My name is James Goldberg, and I am appearing here today as Washington counsel for the National Association of Retail Dealers of America. Headquartered in Lombard, IL, NARDA is a national trade association which represents more than 4,000 companies which sell and service a variety of consumer products, including major appliances, consumer electronics and related items.

Also on the panel today is one of our NARDA members, Circuit City Stores, and you will hear from them in a few minutes.

There have been a lot of questions this morning about some of the concerns in the drafting of your bill, Mr. Dorgan, and that of Mr. Brooks. Let me say at the outset that we share some of those concerns, but our overriding approach is to work with you and the subcommittee staff to solve the problems which may exist in the legislative drafting and get this bill passed in a reasonably rapid period of time.

I think the issue here is one not of administrative problems and enforcement, but the issue is a very simple one, it is $1.5 billion in revenue which is not now being collected by State governments and it is also about a level playing field and fair and equal competition on the part of retailers such as those in the NARDA membership.

This committee recently completed action on a very comprehensive trade bill, and one of the focuses of that omnibus trade legislation was the concept of fair competition, fair trade and a level playing field, and I think that is what we are talking about with this legislation.

Retailers such as the kind that you referred to, Mr. Dorgan, in your opening statement, are beset every day by customers who come in and shop their stores, write down brand name and model numbers and then pick up an 800 number and call a seller in Chicago or New York or southern California or southern Florida or somewhere else and order the same item.

Now, a lot of our members might complain that some of these national sellers have low prices that they do not think are fair. We are not talking about that. We are talking about the extra margin of difference which comes in the noncollection of State sales tax.

It is tough enough, as was referred to by the last panel, for the main street merchant to compete in today's marketplace, without having to compete against a retailer who does not collect sales tax on the exact same item that the main street retailer is selling in his store.

With the notion of business nexus which has been referred to a lot this morning and which is referred to in the *National Bellas Hess* case, I think what this legislation does is to bring the notion of business nexus into the current high-tech age. Twenty years ago, when *National Bellas Hess* was decided, business nexus was thought of in the context of salesmen on the road or use of the U.S. mail. Now, in 1987, we have national publications like USA Today which are transmitting via satellite and published in virtually every city of the country simultaneously.

In the area of television, we have super stations which are carried on most cable systems around the country, giving rise to the phenomenon that baseball teams like the Atlanta Braves or perhaps the Chicago Cubs are thought of as an American team and not just a local entity.

We have toll-free telephone numbers which really were not all that prevalent twenty years ago in the *National Bellas Hess* situation. We are moving into an age of shop-at-home computer usage, where people can sit at a home terminal, dial up a bulletin board or a seller and actually use the computer to order items.

So I think the legislation is needed in order to deal with some of these current notions of business nexus that are prevalent in 1987.

Finally, Mr. Chairman, I would just say in response to some of the questions that Mr. Brown asked earlier, from our standpoint, as retailers, we are not asking that our out-of-State competitors be licensed, and we are not asking that our out-of-State competitors be subjected to State income taxes that they are not now subject to.

What we are simply saying is make these out-of-State competitors compete on a level playing field and collect the sales tax that the rest of retailing is required to collect.

Thank you.

[The statement of Mr. Goldberg follows:]

STATEMENT OF
JAMES M. GOLDBERG
ON BEHALF OF
NATIONAL ASSOCIATION OF RETAIL DEALERS OF AMERICA, INC.
TO THE SUBCOMMITTEE ON SELECT REVENUE MEASURES
HOUSE COMMITTEE ON WAYS AND MEANS
CONCERNING
THE INTERSTATE SALES TAX COLLECTION ACT OF 1987

My name is James M. Goldberg. I am a partner in the Washington law firm of Abrams, Westermeier & Goldberg, P.C. I am appearing here today as Washington Counsel for the National Association of Retail Dealers of America, Inc. (NARDA). Headquartered in Lombard, Illinois, NARDA is a national trade association which represents more than 4,000 companies which sell and service a variety of consumer products, including major appliances, consumer electronics and related items.

We appreciate the opportunity to appear before the Subcommittee today to express NARDA's support for legislation which would authorize state governments to collect sales and use taxes from certain out-of-state sellers.

It has been approximately 20 years since the Supreme Court of the United States, in National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753, ruled that a state or local government cannot constitutionally require a vendor to collect and remit sales and use tax unless that vendor has a sufficient connection with the state. In that case, the Court found that the required "minimum connection" was not present when the vendor's only connection with its customers was by common carrier or the mail.

The National Bellas Hess decision was triggered by the operations of a mail order retailer. In the two decades since that decision, there has been a virtual explosion of mail order selling, with a proliferation of catalogues in use by a variety of product merchandisers. We have also seen the advent of the national publication, with newspapers like USA TODAY, The Wall Street Journal, and The New York Times appearing on the same day in every major city in the country. These newspapers, and others like them, carry advertisements from sellers who feature toll-free telephone numbers so that readers in distant cities can call without charge and order advertised products. The "high tech" age has also seen the beginning of shop-at-home services, using cable television stations and even home computers to generate sales.

All of these types of selling have one common feature: the sellers rarely, if ever, collect sales tax from the jurisdiction into which they are shipping. Using the rationale in National Bellas Hess, these sellers rightfully claim that they do not have the requisite business nexus with the state into which they are shipping merchandise. The toll-free shopping number is the 1980's equivalent of the U.S. mail for advertising and order-taking.

Increasingly, NARDA members and other retailers are competing with these out-of-state sellers. Customers visit the stores of NARDA members, note prices and model numbers, then call toll-free to these national sellers and place their orders. Not only do these national sellers generally sell at prices less than those charged by NARDA members (usually because they do not have some of the overhead expenses which NARDA members must absorb), but they gain a further price advantage because they do not collect state sales taxes. Even if the selling price of the merchandise is identical, customers can still save by not having to pay sales tax on "big-ticket" items.

In our opinion, it is time to put the competition on a level playing field. We urge the Subcommittee to favorably report legislation to overturn the National Bellas Hess decision and permit state and local governments to require collection of sales and use taxes by out-of-state sellers.

There are several items which should be included in any legislation reported by this Subcommittee:

First, the legislation should cover both mail order and telephone sales; in addition, it should cover sales resulting from customer visits to stores, with delivery made to another state.

Second, in order to minimize the paperwork burden on retailers, the legislation should be limited to those businesses which do a minimum amount of dollar volume sales in a particular jurisdiction.

Third, the legislation should contain provisions which make it simple for an out-of-state seller to collect and remit local sales taxes which are in addition to state sales taxes.

Fourth, the legislation should provide for a uniform rule on the definition of where a "sale" taxes place -- e.g., at the point of shipment or the point of receipt -- so that a seller will have clear and unambiguous direction as to which sales tax to collect.

In conclusion, Mr. Chairman, NARDA urges the Subcommittee to move expeditiously with this legislation and to promptly report it to the full Committee. We realize that there may be provisions in H.R. 1242 which need modification and we would be pleased to work with Subcommittee staff members to insure timely consideration of this most important legislative matter.

Mr. DORGAN. Mr. Goldberg, thank you very much.

The Chair would announce that there are two votes that are going to be on the floor of the House. We are in the middle of the first vote. What we would like to do is take a 5 minute statement from Mr. Hausman next, then we will break at that time and reconvene at 12:45.

So the Chair would now recognize Mr. Hausman.

STATEMENT OF ROBERT M. HAUSMAN, COUNSEL, CIRCUIT CITY STORES, INC., ACCOMPANIED BY GEORGE HECHTMAN, DIRECTOR, MARKETING RESEARCH

Mr. HAUSMAN. Thanks very much, Mr. Dorgan.

I appear today as a representative of Circuit City Stores, Inc., the Nation's leading specialty retailer of brand name consumer electronics and major appliances. It has 87 stores in 11 Southeastern States, plus California, and those are listed in my written testimony.

Circuit City, like many similar retailers, is particularly subject to the unfair competition of interstate mail order sellers because it offers brand name merchandise and uses print advertising featuring prices and items, appealing to the price consciousness of the public. Mail order sellers do exactly the same, but they have a sales tax advantage of about $20 on the average color television set or VCR, which is 5 percent of $400. Since the merchandise is identical and easily identified, that advantage can result in a substantial diversion of sales. Moreover, Circuit City has, in recent years, had net operating margins of approximately 5 to 7 percent, and that is a good return by industry standards. But obviously a competitor who can offer the public a 5 to 7 percent lower price simply by not collecting the sales tax can potentially wipe out the profitability of those items for Circuit City and other store retailers and cause Circuit City to abandon certain products or product lines.

Now, the public can be harmed if Circuit City and other store retailers decide to meet the price competition in a way that is possible for them, that is by reducing the service component of the bundle of merchandise and service. That would not be an economic choice by the customer. It would be a hidden reduction in value, one which is forced on the store retailer.

By not passing enabling legislation such as H.R. 1242, Congress tacitly adopts certain elements of public policy and the question is whether Congress means to do so. Thus, by inaction Congress disfavors sales and use taxes as a proper source of State and local tax revenues, denies store retailers who are the backbone of the distribution system a level playing field, skews the economics of retailing to favor solicitation from outside the State, and encourages a consumer state of mind that seeks devices for tax avoidance and even unlawful tax evasion.

The Brooks bill, H.R. 1891, appears to us to have a more effective definition of the person on whom the obligation to collect the tax may be imposed. It says "a State shall have power to require a person to collect a State sales tax imposed with respect to the sale of tangible personal property if the destination of sale is in such State, and such a person engages in regular or systematic solicita-

tion of sales in the State," and that appears to us to be preferable to trying to define a retailer "engaged in business in that State."

The latter seems to be evadable by the kind of ingenuity that will be called forth once the bill has been passed. As one example, we can envision a person holding himself out as a broker, rather than as a retailer, to take orders and price them at stated prices with unnamed suppliers who then ship directly to the consumer. The broker would fit into the Brooks bill definition, but he would seem to escape the definition in H.R. 1242.

Now, I have with me, accompanying me on my right Mr. George Hechtman, who is Circuit City's director of marketing research.

Circuit City does do some telephone sales in a very limited way, confined to the Washington, DC, area, and Mr. Hechtman has very recently put together some information and some figures which I would like him to share with you.

Mr. DORGAN. Mr. Hechtman.

Mr. HECHTMAN. Thank you.

About 1 year ago we started a local service in the Washington area only aimed at allowing customers to phone orders into our Maryland offices, customers who were unable to reach one of our stores in the suburban Washington area.

This is an extremely small part of our business, accounting for less than what a typical sales person would write in a single store in a month.

What we have found is that most of the business is going to States outside of the metropolitan area and our sales people that man this phone line are finding a large number of instances where consumers are visiting our stores and then phoning in on the line for the sake of avoiding the sales tax on the products, so that our store will provide the service information to the consumer and the consumer, in the interest of saving the 1 to 5 percent sales tax, then calls in for a direct line approach.

Mr. DORGAN. So you are saying the procedure itself is one that seems intent on avoiding the sales tax responsibility?

Mr. HECHTMAN. We are finding that that is a large part of the consumer attraction to this service.

Mr. DORGAN. Thank you very much, Mr. Hechtman, for that testimony.

[The statement of Mr. Hausman follows:]

TESTIMONY OF ROBERT M. HAUSMAN, ESQ.
ON BEHALF OF CIRCUIT CITY STORES, INC.
BEFORE THE SUBCOMMITTEE ON SELECT REVENUE MEASURES
OF THE COMMITTEE ON WAYS AND MEANS
WITH RESPECT TO H.R. 1242,
THE INTERSTATE SALES TAX COLLECTION ACT OF 1987
MAY 13, 1987

Honorable Chairman Wrangle and members of the Subcommittee: Circuit City Stores, Inc., appreciates this opportunity to appear before you on a matter of importance to it.

Circuit City is the nation's leading specialty retailer of brand name consumer electronics and major appliances. It has 87 stores in eleven southeastern states plus California, 6000 employees, and 3000 stockholders. All Circuit City stores are located in states with sales taxes. The distribution of stores, by state, is set forth on page 2.

Circuit City, like many similar retailers, is particularly subject to the unfair competition of interstate mail order sellers because it offers brand name merchandise and uses print advertising featuring prices and items, appealing to the price-consciousness of the public. Mail order sellers do the same, but they have a sales tax advantage of about $20 on the average color television set or VCR (5% of $400). Since the merchandise is identical and easily identified, that advantage can result in a substantial diversion of sales. Moreover, Circuit City has, in recent years, had net operating margins of approximately 5% to 7%. This represents a good return by industry standards. Obviously, a competitor who can offer the public a 5% to 7% lower price by simply not collecting sales tax can potentially wipe out the profitability of those items for Circuit City and cause Circuit City to abandon certain products or product lines. That means reducing employment and/or increasing the overhead allocable to other lines, increasing the price to the public.

The public can also be harmed if Circuit City and other store retailers decide to meet the price competition by reducing the service component of the bundle of merchandise and service that they provide to customers. That would not be an economic choice by the customer, but a hidden reduction in the value delivered which is forced on the store retailer by the need to cut the expense of sales to compensate for the sales tax disadvantage.

Nationwide television and print advertising plus the use of 800 numbers and credit cards has enormously increased the ease and volume of remote sales. There may be efficiencies in such purchasing and selling, and we don't ask for protection from them. We want to meet such sellers with our own service advantages and efficiencies, without a 5% to 7% tax disadvantage and the burden of collecting and remitting the tax when our remote sales competitor is free of those impediments.

Circuit City Stores urges the Congress to adopt legislation enabling the states to require suppliers to collect sales or use taxes when they ship or deliver goods to consumers in a sales tax state, and to facilitate enforcement through information returns filed with the IRS.

Forty six states in the nation, including every state in which Circuit City has a store location, depend on a sales tax for a portion of their state revenues. There seems to be no reason for Congress to allow such state sales taxes to be evaded by sellers who ship or deliver goods to consumers in those states. By not passing enabling legislation such as H.R. 1242, Congress tacitly adopts certain elements of public policy, and the question is whether Congress means to do so. Thus, by inaction, Congress (1) disfavors sales and use taxes as a proper source of state and local tax revenues, (2) denies store retailers, who are the backbone of our distribution systems, a level playing field, (3) skews the

economics of retailing to favor solicitation from outside the state by broadcast, telephone and print media, and shipment to the consumer from outside the state, and (4) encourages a consumer state of mind that seeks devices for tax avoidance, and even unlawful tax evasion.

We have not made a study of the technical provisions of H.R. 1242 as compared with other possible legislative solutions, but we have a few observations on the provisions of the bill.

The Brooks Bill, H.R. 1891, appears to have a more effective definition of the person on whom the obligation to collect the tax may be imposed. It says, "a state shall have power to require a person to collect a state sales tax imposed with respect to the sale of tangible personal property if (1) the destination of sale is in such state, and (2) such a person engages in regular or systematic solicitation of sales in such state ...." That appears preferable to trying to define a retailer "engaged in business in that state," as in H.R. 1242, which seems evadable by the kind of ingenuity that will be called forth once the bill is passed. As one example, we can envision a person holding himself out as a broker, rather than as a retailer, to take orders and place them at stated prices with unnamed suppliers who then will ship directly to the consumer. The broker would fit within the Brooks bill definition, but he would seem to escape H.R. 1242.

Congress should enact whatever formulation seems simplest and most effective. The Supreme Court is most likely to defer to the Congress in matters affecting interstate commerce. If there are concerns whether the Supreme Court would uphold the best formula, a "fallback" formula can be enacted as Title II of the Act, to take effect if the Supreme Court should invalidate Title I.

The following appendix shows the locations of Circuit City stores, by state.

CIRCUIT CITY STORES, INC.

Number Stores by State

Alabama	5
California	20
Florida	3
Georgia	8
Indiana	1
Kentucky	3
Maryland	8
North Carolina	9
South Carolina	5
Tennessee	8
Virginia	15
West Virginia	2
TOTAL	87

Mr. DORGAN. I would like to indicate that Mr. Chesnick, you will be called upon at 12:45, if the rest of the panel will reconvene. We would appreciate it, Mr. Goldberg, if you and Mr. Hausman could come back as well.

The subcommittee stands in recess until 12:45.

[Whereupon, at 12:17 p.m., the subcommittee recessed, to reconvene at 12:45 p.m.]

AFTERNOON SESSION

Mr. DORGAN. The Chair would call the subcommittee to order.

When we recessed, we were hearing from a panel of the National Association of Retail Dealers of America, Circuit City Stores, Inc., Georgetown Manor; Plunkett Furniture, and National Association of Retail Druggists.

We had just heard from Mr. Hausman and Mr. Hechtman, from Circuit City. We are now prepared to hear a statement from Mr. Joseph Chesnick, Jr., from Georgetown Manor, Houston, TX.

Mr. Chesnick, we would be happy to hear your statement and your entire statement will be made a part of the permanent committee record.

STATEMENT OF JOSEPH CHESNICK, JR., PRESIDENT, GEORGETOWN MANOR, INC., AND ROBERT JOSEPH INTERIORS, INC., HOUSTON, TX

Mr. CHESNICK. Mr. Chairman and members of the subcommittee, thank you for the opportunity to testify in support of the proposed Interstate Sales Tax Collection Act of 1987. My name is Joe Chesnick, Jr., and I represent myself as president of my family-owned retail home furnishings corporation.

Based in Houston, Texas, we are incorporated under the names of Georgetown Manor and Robert Joseph Interiors, operating seven stores in south Texas, including the trade areas of Houston, San Antonio, Beaumont, and Corpus Christi. We sell middle to high-priced merchandise and presently employ 110 people and currently carry a wholesale inventory valued at $6 million.

I am a former director and present member of the Southwest Home Furnishings Association, representing the retail furniture dealers in Texas, Louisiana, Oklahoma, Arkansas, Kansas and New Mexico.

For the past 5 years, from operating my own stores and from attending both national and regional retail meetings, I have experienced and become aware of a national crisis in our business pertaining to unfair competition from out-of-State companies shipping into local trade areas with the advantage of not being required to charge State sales tax.

In my industry, the large majority of the furniture manufacturers are located in the State of North Carolina. A large network of low overhead suburban outlet stores developed due to their close proximity to the factories, therefore eliminating their in-coming freight costs. As more of these type of operations opened, they found their market share diminishing and decided the best way to survive was to solicit out-of-state business, emphasizing their dis-

count prices and the big advantage of no State sales tax to the consumer.

Not only did these companies survive, but business boomed as their marketing techniques became more sophisticated. Incoming toll-free numbers, print advertisements in national shelter magazines and both national and local newspapers such as the Wall Street Journal and the Houston Chronicle, has been their most successful marketing strategy. These order takers encourage a customer to go into the local stores and "get a stock number" for pricing reference purposes.

In addition, these North Carolina retailers have established a separate network of representatives that arrange and conduct suburban subdivision consumer meetings stating the advantages of saving the State sales tax on their purchases. I have attended several of these meetings and know this as a fact. Also—and I will use San Antonio as an example with five major military installations—representatives are established to circulate among the various bases advising potential customers of the sales tax savings.

Obviously, these companies have both the right and opportunity to sell and ship their products where they want and at whatever price. I feel, though, that we can compete against their discounted prices by offering the many advantages of a full-service store, but with the added incentive of not paying a State sales tax which can amount to hundreds and even thousands of dollars on our priced merchandise, it is virtually impossible to compete. When we do absorb the sales tax in order to match their price, we virtually lose money on that sale.

I would like to briefly describe to you what we experience on a daily basis not only in my stores, but in stores across the country. Consumers come at the advice of the North Carolina retail agents and literally steal our sales people's catalogs and price lists, they turn furniture upside down in order to copy down the stenciled stock number, shoot both still and video photography within our stores for identification purposes. These shoppers unfairly use my employees' time and take complete advantage of my business, where I am paying all the operating and inventory expenses, so that they can order direct from North Carolina and save the State of Texas sales tax. I have had to resort to the coding of my stock numbers on our merchandise and samples which takes a great deal of time and expense in a futile attempt to protect myself.

It is important to point out that under the present nontaxable system, I personally cannot blame a consumer for attempting to buy our product at the best possible price. This is only human nature and as an American consumer we all shop for the best possible value.

But, under the present nontaxable system, I am a retailer, operating at an unfair disadvantage. I take the responsibility as an employer very seriously as the welfare of 110 people and their families are dependent on my decisions and actions. They understand that in order to be successful on a local basis, in a highly competitive atmosphere, complete professionalism is required at all times.

It becomes very unfair when they maintain this professionalism, but their security and benefits are jeopardized due to out-of-State firms selling in my trade area with the distinct advantage of not

collecting State sales tax. I am not looking for a free ride, only for the opportunity to compete fairly under the same State sales tax guidelines.

I am very proud to have the opportunity to operate a business in our free enterprise system. This system, though, needs Federal legislation passed so that retailers across the country will have a "fair" opportunity to compete against the direct marketers who currently do not collect a State sales tax on their customers' purchases.

It is this current state of "unfairness" that compels me to urge your support of H.R. 1242. Thank you.

[The statement of Mr. Chesnick follows:]

STATEMENT OF JOSEPH CHESNICK, JR., PRESIDENT,
ROBERT JOSEPH INTERIORS AND GEORGETOWN MANOR, INC.

MAY 13, 1987

SELECT REVENUE MEASURES SUBCOMMITTEE
HOUSE WAYS AND MEANS COMMITTEE
1102 LONGWORTH HOUSE OFFICE BUILDING
WASHINGTON, D.C. 20515

RE: HR1242

DEAR MR. CHAIRMAN AND MEMBERS OF THE COMMITTEE:

THANK YOU FOR THE OPPORTUNITY TO TESTIFY IN SUPPORT OF THE PROPOSED "INTERSTATE SALES TAX COLLECTION ACT OF 1987." MY NAME IS JOSEPH CHESNICK, JR. AND I REPRESENT MYSELF AS PRESIDENT OF MY FAMILY OWNED RETAIL HOMEFURNISHINGS CORPORATION. BASED IN HOUSTON, TEXAS WE ARE INCORPORATED UNDER THE NAMES OF GEORGETOWN MANOR AND ROBERT JOSEPH INTERIORS, OPERATING SEVEN STORES IN SOUTH TEXAS INCLUDING THE TRADE AREAS OF HOUSTON, SAN ANTONIO, BEAUMONT, AND CORPUS CHRISTI. WE SELL MIDDLE TO HIGH PRICED MERCHANDISE AND PRESENTLY EMPLOY 110 PEOPLE AND CURRENTLY CARRY A WHOLESALE INVENTORY VALUED AT $6,000,000. I AM A FORMER DIRECTOR AND PRESENT MEMBER OF THE SOUTHWEST HOMEFURNISHINGS ASSOCIATION, REPRESENTING THE RETAIL FURNITURE DEALERS IN TEXAS, LOUISIANA, OKLAHOMA, ARKANSAS, KANSAS AND NEW MEXICO.

FOR THE PAST FIVE YEARS, FROM OPERATING MY OWN STORES AND FROM ATTENDING BOTH NATIONAL AND REGIONAL RETAIL MEETINGS, I HAVE EXPERIENCED AND BECOME AWARE OF A NATIONAL CRISIS IN OUR BUSINESS PERTAINING TO "UNFAIR COMPETITION" FROM OUT OF STATE COMPANIES SHIPPING INTO LOCAL TRADE AREAS WITH THE ADVANTAGE OF NOT BEING REQUIRED TO CHARGE STATE SALES TAX.

IN MY INDUSTRY, THE LARGE MAJORITY OF THE FURNITURE MANUFACTURERS ARE LOCATED IN THE STATE OF NORTH CAROLINA. A LARGE NETWORK OF LOW OVERHEAD - SUBURBAN OUTLET STORES DEVELOPED DUE TO THEIR CLOSE PROXIMITY TO THE FACTORIES, THEREFORE ELIMINATING THEIR IN-COMING FREIGHT COSTS. AS MORE OF THESE TYPE OF OPERATIONS OPENED, THEY FOUND THEIR MARKET SHARE DIMINISHING AND DECIDED THE BEST WAY TO SURVIVE WAS TO SOLICIT OUT OF STATE BUSINESS, EMPHASIZING THEIR DISCOUNT PRICES AND THE BIG ADVANTAGE OF NO STATE SALES TAX TO THE CONSUMER.

NOT ONLY DID THESE COMPANIES SURVIVE, BUT BUSINESS BOOMED AS THEIR MARKETING TECHNIQUES BECAME MORE SOPHISTICATED. IN-COMING TOLL-FREE NUMBERS, PRINT ADVERTISEMENTS IN NATIONAL SHELTER MAGAZINES AND BOTH NATIONAL AND LOCAL NEWSPAPERS SUCH AS THE WALL STREET JOURNAL AND THE HOUSTON CHRONICLE, HAS BEEN THEIR MOST SUCCESSFUL MARKETING STRATEGY. THESE ORDER TAKERS ENCOURAGE A CUSTOMER TO GO INTO THE LOCAL STORES AND "GET A STOCK NUMBER" FOR PRICING REFERENCE PURPOSES.

IN ADDITION, THESE NORTH CAROLINA RETAILERS HAVE ESTABLISHED A SEPARATE NETWORK OF REPRESENTATIVES THAT ARRANGE AND CONDUCT SUBURBAN SUB-DIVISION CONSUMER MEETINGS STATING THE ADVANTAGES OF SAVING THE STATE SALES TAX ON THEIR PURCHASES. I HAVE ATTENDED SEVERAL OF THESE MEETINGS AND KNOW THIS AS A FACT. ALSO, AND I WILL USE SAN ANTONIO AS AN EXAMPLE WITH FIVE MAJOR MILITARY INSTALLATIONS, REPRESENTATIVES ARE ESTABLISHED TO CIRCULATE AMONG THE VARIOUS BASES ADVISING POTENTIAL CUSTOMERS OF THE SALES TAX SAVINGS.

OBVIOUSILY, THESE COMPANIES HAVE BOTH THE RIGHT AND OPPORTUNITY TO SELL AND SHIP THEIR PRODUCTS WHERE THEY WANT AND AT WHATEVER PRICE. I FEEL THOUGH, THAT WE CAN COMPETE AGAINST THEIR DISCOUNTED PRICES BY OFFERING THE MANY ADVANTAGES OF A FULL-SERVICE STORE SUCH AS IN-HOME INTERIOR DESIGN ASSISTANCE, COMPETITIVE PRICING, A BEAUTIFUL SHOWROOM AND FREE DELIVERY,SET-UP AND SERVICE IN THE CUSTOMER'S HOME. BUT, WITH THE ADDED INCENTIVE OF NOT PAYING A STATE SALES TAX, WHICH CAN AMOUNT TO HUNDREDS AND EVEN THOUSANDS OF DOLLARS ON OUR PRICED MERCHANDISE, IT IS VIRTUALLY IMPOSSIBLE TO COMPETE. WHEN WE DO ABSORB THE SALES TAX IN ORDER TO MATCH THEIR PRICE, WE VIRTUALLY LOSE MONEY ON THAT SALE.

I WOULD LIKE TO BRIEFLY DESCRIBE TO YOU WHAT WE EXPERIENCE ON A DAILY BASIS NOT ONLY IN MY STORES, BUT IN STORES ACROSS THE COUNTRY. CONSUMERS COME AT THE ADVICE OF THE NORTH CAROLINA RETAIL AGENTS AND LITERALLY STEAL OUR SALES PEOPLE'S CATALOGS AND PRICE LISTS, TURN FURNITURE UPSIDE DOWN IN ORDER TO COPY DOWN THE STENCILED STOCK NUMBER, SHOOT BOTH STILL AND VIDEO PHOTOGRAPHY WITHIN OUR STORES FOR IDENTIFICATION PURPOSES. THESE SHOPPERS UNFAIRLY USE MY EMPLOYEE'S TIME AND TAKE COMPLETE ADVANTAGE OF MY BUSINESS, WHERE I AM PAYING ALL THE SELLING, OCCUPANCY, DELIVERY AND ADMINISTRATIVE EXPENSES, NOT TO MENTION INVENTORY COSTS, SO THAT THEY CAN ORDER DIRECT FROM NORTH CAROLINA AND SAVE THE STATE OF TEXAS SALES TAX. I HAVE HAD TO RESORT TO THE CODING OF MY STOCK NUMBERS ON OUR MERCHANDISE AND SAMPLES WHICH TAKES A GREAT DEAL OF TIME AND EXPENSE IN A FUTILE ATTEMPT TO PROTECT MYSELF.

I CLOSELY MONITOR THIS SITUATION AND FREQUENTLY CALL TO FIND OUT THE NEWEST TECHNIQUES OF THESE NORTH CAROLINA RETAILERS. THEIR PRESENT PHILOSPHY CONSISTS OF HAVING A LIST OF THE BETTER KNOWN INDEPENDENT RETAILERS IN A PARTICULAR CITY AND ADVISING THIER POTENTIAL CLIENTS THAT THESE STORES HAVE BEEN PLACED AROUND THE COUNTRY BY THE MANUFACTURERS STRICTLY FOR THE PURPOSE OF ASSISTING PEOPLE IN BUYING FROM NORTH CAROLINA. ONE POINT NEVER CHANGES, THE FACT THAT THEY WILL SHIP ANYWHERE OUTSIDE THE STATE OF NORTH CAROLINA, THEREFORE ELIMINATING THE EXPENSE OF ANY STATE SALES TAX.

IT IS IMPORTANT TO POINT OUT THAT UNDER THE PRESENT NON-TAXABLE SYSTEM, I PERSONALLY CANNOT BLAME A CONSUMER FOR ATTEMPTING TO BUY OUR PRODUCT AT THE BEST POSSIBLE PRICE. THIS IS ONLY HUMAN NATURE AND AS AN AMERICAN CONSUMER, WE ALL SHOP FOR THE BEST POSSIBLE VALUE.

BUT, UNDER THE PRESENT NON-TAXABLE SYSTEM, I AS A RETAILER, OPERATE AT AN UNFAIR DISADVANTAGE. I TAKE THE RESPONSIBILITY AS AN EMPLOYER VERY SERIOUSILY AS THE WELFARE OF 110 PEOPLE AND THEIR FAMILIES ARE DEPENDENT ON MY DECISIONS AND ACTIONS. THEY UNDERSTAND THAT IN ORDER TO BE SUCCESSFUL ON A LOCAL BASIS, IN A HIGHLY COMPETITIVE ATMOSPHERE, COMPLETE PROFESSIONALISM IS REQUIRED AT ALL TIMES. IT BECOMES VERY UNFAIR WHEN THEY MAINTAIN THIS PROFESSIONALISM, BUT THEIR SECURITY AND BENEFITS ARE JEOPARDIZED DUE TO OUT OF STATE FIRMS SELLING IN MY TRADE AREA WITH THE DISTINCT ADVANTAGE OF NOT COLLECTING STATE SALES TAX. I AM NOT LOOKING FOR A FREE RIDE, ONLY THE OPPORTUNITY TO COMPETE FAIRLY UNDER THE SAME STATE SALES TAX GUIDELINES.

I AM VERY PROUD TO HAVE THE OPPORTUNITY TO OPERATE A BUSINESS IN OUR FREE ENTERPRISE SYSTEM. THIS SYSTEM THOUGH, NEEDS FEDERAL LEGISLATION PASSED SO THAT RETAILERS ACROSS THE COUNTRY WILL HAVE A "FAIR" OPPORTUNITY TO COMPETE AGAINST THE DIRECT MARKETERS WHO CURRENTLY DO NOT COLLECT A STATE SALES TAX ON THEIR CUSTOMER'S PURCHASES.

IT IS THIS CURRENT STATE OF "UNFAIRNESS" THAT COMPELS ME TO URGE YOUR SUPPORT OF HR1242.

THANK YOU AGAIN FOR YOUR TIME AND ATTENTION.

SINCERELY,

GEORGETOWN MANOR, INC.
ROBERT JOSEPH INTERIORS, INC.

Joseph Chesnick, Jr.

JOSEPH CHESNICK, JR.
PRESIDENT

JCj/mh

Carolina Interiors

DEAR PROSPECTIVE CUSTOMER

Thank you for your interest in Carolina Interiors! You have obviously written to us because you realize you can save money by buying furniture in North Carolina. At Carolina Interiors we not only give you low furniture prices, we give you advantages many other North Carolina furniture dealers do not.

FIRST QUALITY ... never seconds. Your merchandise is inspected in our warehouse before it is shipped to you.

SURETY BOND ... given on all deposits. This is your assurance of a refund if we fail to fulfill the commitment to deliver the furniture you select.

ONLY A ONE-THIRD DEPOSIT ... most stores require 50% 100% in advance.

ORDERS ARE PLACED IMMEDIATELY ... we never hold orders. As soon as we determine factory availability you are acknowledged. You have the right to cancel at this time.

WE DO NOT DROP SHIP ... unless you specify this method. Carolina Interiors prefers to bring merchandise to our warehouse where we can personally inspect it before it is shipped to you. This method costs us more money, but we believe it eliminates many problems before they occur.

STAFF OF INTERIOR DESIGNERS ... professionally trained with expert knowledge of all the finest lines.

[redacted]

Carolina Interiors is locally owned by men who have over 48 years experience in the furniture business. With five large stores in the heart of furnituretand we deliver and ship worldwide. If you are ever in our area, we extend these services to you at our showroom, one of the largest in North Carolina. We are located about twenty miles south of Charlotte on Highway 321 in Kings Mountain, North Carolina, the furniture manufacturer. Our showroom is directly beside the Carolina Home Fashions Outlet. There is an entrance between the two showrooms. Together these stores cover an entire city block with an entrance on both streets.

WE CAUTION YOU ...

Many furniture companies operate with only a small office and no furniture on display, no inspection of merchandise before shipping and no protection on your deposit. We invite you to check Lyons and Dunn & Bradstreet to compare our ratings with other companies.

At Carolina Interiors our goal is to please our customers and to offer you every advantage available. We not only want to do business with you again and again, we want you to tell your friends about us. Once again, thank you for writing and I hope you will let us hear from you soon.

Sincerely,

M. Rodger Vandenburg Jr.

M. Rodger Vandenburg, Jr.
Vice President

TELEPHONE — Toll Free Outside N.C. 1-800-438-6111 • From Charlotte Direct 322 1121 • Other North Carolina (704) 922 2261

DEPOSITS PROTECTED BY SURETY BOND

Mr. DORGAN. Thank you, Mr. Chesnick.

Our next witness is Mr. John T. Plunkett, an owner of Plunkett Furniture Co., from Arlington Heights, IL.

Mr. Plunkett.

STATEMENT OF JOHN T. PLUNKETT, PRESIDENT, SHOWCASE STORE DIVISION, PLUNKETT FURNITURE CO., ARLINGTON HEIGHTS, IL

Mr. PLUNKETT. Thank you. I am John Plunkett, a division president of Plunkett Furniture Co. We have a total of eight Chicagoland stores. In the jargon used by marketing consultants, we cater to an upper-middle, an upper, and some upper-upper consumer profiles. We have a staff of approximately 75 sales associates, almost all of whom have either a specialty school or a full university degree in interior design.

Last year, our sales were $26.5 million. We collected and paid $1,707,000 in Illinois and local sales taxes. Our real estate taxes in support of local schools and community programs were about $400,000.

I would like to talk briefly on the debilitating effect of the avoidance of sales and use taxes has on main street furniture merchants. In our trading area, the sales tax varies between 6.5 and 8 percent. The latter is paid on sales delivered into the city of Chicago. As an example, the tax on a $15,000 dining room set delivered into Chicago is $1,200.

While we are most impacted by North Carolina dealers, we are also affected by untaxed border sellers. A few dealers from neighboring States advertise in the Chicago Tribune and upscale Chicago periodicals like North Shore Magazine. Business and individual purchasers of carpeting and furnishings buying from these resources usually avoid the sales and use taxes. However, these border sellers are less formidable than the direct marketers.

In the home furnishing industry, I consider direct marketers as those out-of-State dealers who free ride on the displays and design talents of main street merchants, while affording the customer the ability to avoid all sales taxes, and the higher real estate taxes imposed on dealers in major cities. These firms solicit price-conscious young professionals through small ads in newspapers like the Wall Street Journal and the most fashionable home shelter magazines. Generally, savings of 40 percent on over 200 furniture lines are proclaimed by calling an 800 number. While their literature does not note the sales tax savings, they are usually fast to mention it in their telephone sales presentation as part of the discount package.

One-third of the Nation's furniture retailers went out of business since 1979, and the number that took ads in telephone yellow pages dropped from 23,000 in 1978 to 16,400 in 1985. Department store sales of furniture have also been similarly affected. Because of declines, department stores, once the purveyors of the finest home furnishings, have shifted their business towards bedding, imported or private label bedroom and dining selections and harder to shop upholstered furniture. Their market share has slipped over the past few years from 15 percent to a total of about 10 percent today.

The same thing has been happening in better quality home furnishings stores. Either they have had to change their emphasis to less expensive merchandise or in many cases go out of business. This continues to happen in most every major marketing area within striking distance of North Carolina. As State legislators seek to underwrite programs with increases in sales taxes, our chances of survival diminish.

Largely because of this disparity in the collection of taxes, the beneficiaries of this change have been the so-called discount catalog sellers or direct merchants. Their market share has increased from near zero a few years ago to about 7 to 10 percent today, and is projected to increase at an average rate of 12 percent per annum.

My testimony today is in support of Representative Dorgan's bill, the Interstate Sales Tax Collection Act of 1987. This or similar legislation will not only help level the playing field for taxpayers and main street merchants, but also provide a rich source of uncollected State revenues.

National retail sales of furniture and sleep equipment are projected at $32.6 billion in 1987. Failure to collect sales taxes on 10 percent of these purchases becomes a significant amount.

An article that recently appeared in the Sunday Chicago Tribune estimates that at-home shopping sales will total more than $65 billion this year and will grow 12 percent annually. It further states that while this figure is a small portion of the $1.7 trillion in retail sales expected in 1987, at-home sales could rise to about a third of all retail business within a decade.

Obviously, the inequity and loss of revenue on out-of-State sales will ultimately become totally unacceptable to the taxpayers and governmental bodies. I believe that now is the time to act on the type of legislation proposed by Representative Dorgan.

Thank you. I feel very honored and privileged to be here today.

[The statement of Mr. Plunkett follows:]

JOHN T. PLUNKETT
report to
SELECT REVENUE MEASURES SUBCOMMITTEE
of the
HOUSE WAYS AND MEANS COMMITTEE
regarding
REVENUE LOSSES AND UNFAIR COMPETITION
FROM UNTAXED OUT-OF-STATE BUSINESSES

Business History

I am John T. Plunkett, President of Plunkett Furniture Co., Showcase Store Division. My office is in Arlington Heights, Illinois. Our Company has a total of eight Chicagoland stores. One is in the northwest corner of the City of Chicago and the others are in Chicago suburban communities.

They are as follows:

Plunkett Furniture Co.	
Drexel Heritage Showcase	Arlington Heights, IL
Drexel Heritage Showcase	Orland Park, IL
Drexel Heritage Showcase	Skokie, IL
Plunkett Furniture Co.	
Full Line Store	Aurora, IL
Full Line Store	Chicago, IL
Full Line Store	Lombard, IL
Full Line Store	River Forest, IL
Full Line Store	Vernon Hills, IL

Our Company was founded by my father in 1931. He built the nucleus of a consumer orientated, home furnishings business and it has grown under the direction of my brother, my family and me. In the jargon used by marketing consultants we cater to an upper-middle, an upper, and some upper-upper type consumers. We have a staff of approximately 75 sales associates almost all of whom have, either a "Specialty School" or a "Full University Degree" in Interior Design. Many are members of the American Society of Interior Designers or the Interior Design Society. These are the foremost professional organizations in the industry.

Last year our Company sales were $26.5 million. We collected and paid $1,707,313 in Illinois and local sales tax. Our real estate taxes in support of local schools and community programs were about $400,000. Employment was 220 full time plus about 40 part time people.

Debilitating Effect of Unfair Competition

I would like to talk briefly on the debilitating effect the avoidance of sales and use taxes has on local furniture stores.

In this trading area the sales tax varies between 6.5% and 8%. The latter is paid on sales delivered into the City of Chicago. 5% of the total sales tax is retained by the State of Illinois and the remainder is distributed to the local taxing authorities. Obviously these rates represent a significant amount on a large purchase. As an example, the tax on a $15,000 dining set delivered into the City of Chicago is $1,200.

Although we have enacted measures to make taking catalogue and fabric numbers more difficult we still feel that we have a slippage factor of about 20% to 25% on major purchases.

Effect of Border Sellers On Our Business

While we are most impacted by out-of-state dealers, namely from North Carolina, we are also affected by untaxed border sellers. A few dealers from neighboring states advertise in the Chicago Tribune and upscale Chicago periodicals like North Shore Magazine. Business and individual purchasers of carpeting and furnishings from these resources usually avoid the sales and use taxes. However, because these border sellers have relatively the same operating and overhead costs as we, they are far less formidable than the direct marketers.

Effect of Direct Marketers On Our Business

In the home furnishings industry I consider direct marketers as those out-of-state dealers namely from North Carolina, who free ride on the displays and design talents of Main Street merchants, while affording the customer the ability to avoid all sales taxes, and the higher real estate taxes imposed on dealers in major cities. These firms solicit price conscious young professionals thru small ads in newspapers like the Wall Street Journal and the most fashionable home shelter magazines. Generally savings to 40% on over 200 furniture lines are proclaimed by calling an 800 number. While their literature does not note the sales tax savings, they are usually fast to mention it in their telephone sales presentation.

Some of the other methods in which direct marketers reach consumers are as follows:

1. Direct mailings to targeted profiles of consumers from lists purchased from credit card companies and mailing services.

2. Providing free catalogues and incentives thru benefit plan administrators of major corporations to encourage employees to shop locally and then to purchase from a favored direct marketer.

3. Marketing thru data-base operators like Dow Jones, Compu-Serve, and Comp-U-Card as well as buying clubs.

4. By retaining public relations firms to proclaim their message with editorials in local and major newspapers and magazines across our Country.

5. By making merchandise available thru home shopping television networks.

Results of Out-of-State Competition

According to Jerry Epperson of Wheat First Securities, one-third of the nations furniture retailers went out of business between 1979 and 1983; and the number that took ads in telephone Yellow Pages dropped from 23,000 in 1978 to 16,400 in 1985. Department store sales of furniture have been similarly affected.

Because of declining sales, department stores, once the purveyors of the finest home furnishings have shifted their business towards bedding, imported or private-label bedroom and dining selections, and harder to shop lines of upholstered furniture. This trend continues as stores down size their furniture displays and oftentimes even exclude such departments from new store locations. According to Mr. Epperson their market share has slipped over the past few years from 15% of the total to about 10% today.

Largely because of this disparity in the collection of sales taxes, the same thing has been happening to better quality home furnishing stores. Either they have had to change their emphasis to less expensive merchandise or, in many cases, go out of business. This not only has happened but continues to happen in most every major marketing area within striking distance of North Carolina. As State Legislators seek to underwrite programs with increases in sales taxes, our chances of survival diminish.

In the Chicago trading area names like John M. Smyth, Wilson Jump, Julians and Vignolas have closed or have changed their merchandise mix. Nationally famous furniture names such as Sloans in New York, Duffys in Dallas, and Brandons in Minneapolis are now statistics.

The beneficiaries of this change have been the so-called discount catalogue sellers. Their market share has increased from near zero five years ago to about 8% today and is projected to increase at an average rate of 12% per annum.

Support of the Interstate Sales Tax Collection Act of 1987

My testimony today is in support of Representative Brian

Dorgan's bill, H.R. 1242, stated as the "Interstate Sales Tax Collection Act of 1987." This or similar legislation will not only help level the playing field for taxpayers and Main Street merchants but also provide a rich source of uncollected state revenues.

According to the Survey of Buying Power Data Service national retail sales of furniture and sleep equipment were $27.9 billion in 1985. This would project sales of $30.5 billion in 1986 and $32.6 billion in 1987. Failure to collect sale or use taxes on 10% of these purchases becomes a significant amount. It is over an $8 million revenue loss in Illinois alone.

Attached is a copy of a study by the ACIR of Projected State Revenue Losses from Mail-Order Sales for 1985. It indicates that the loss of taxes from furniture sales represent only the tip of the iceberg when compared to the estimated combined loss of almost $1.5 billion in taxes on all merchandise categories for 1985.

An article that appeared in the April 12, 1987 edition of the Chicago Sunday Tribune estimates that at-home shopping sales will total more than $65 billion this year and will grow 12% annually. It states that while this is a small portion of the $1.7 trillion in all retail sales expected in 1987, at-home sales could rise to about a third of all retail business within a decade.

Recommendation

Obviously the inequity and loss of revenue on out-of-state sales will become totally unacceptable to taxpayers and governmental bodies.

I believe that now is the time to act on the type of legislation proposed by Representative Dorgan.

Respectfully submitted,

John T. Plunkett

JTP/jtc
Enclosure: ACIR Study

Mr. DORGAN. Mr. Plunkett, thank you very much for your testimony.

Next we will hear from John Rector, the National Association of Retail Druggists.

Mr. Rector.

STATEMENT OF JOHN M. RECTOR, GENERAL COUNSEL AND VICE PRESIDENT FOR GOVERNMENT AFFAIRS, NATIONAL ASSOCIATION OF RETAIL DRUGGISTS

Mr. RECTOR. Thank you very much for the opportunity to support H.R. 1242 today. We certainly echo the numerous comments made about the need for a level playing field and certainly approach this issue and related matters with that as our primary concern.

As you know, our organization represents the dispensers of the overwhelming majority of prescription drugs in the United States. We are also intimately involved with health and beauty aids and a whole host of items that you associate with a typical retail pharmacy. In addition, an increasing number of our members are involved in high-tech home health care products and a number of other items that are for sale or rent.

In each and every one of those areas we are confronted on an ever-increasing basis by very intense, pervasive, well financed interstate mail order operations, particularly recently in the home health care area, Baxter Travenol being a particular company, for instance.

We would like to focus, however, on a wrinkle in this that might not otherwise get a lot of attention. Not that we want to make your problem solving more complex, but you will note in our prepared remarks that we liken the activities of these tax evaders that are for profit very much to the activities of the commercial nonprofits that are in the same business. We do not see any particular difference between a Baxter Travenol that may not be paying taxes in a for-profit context and, say, the AARP nonprofit pharmacy services that operates with all the blessing of nonprofits and similarly acts in a tax-exempt way paying no taxes.

Thus, one of our primary recommendations is that as Chairman Pickle looks at the issues of commercial nonprofit competitors in the Oversight Subcommittee, we would hope that you would also see the parallel here and that you seriously consider in the definition of retailer, including commercial nonprofits under the scope of the interstate collection of tax facilitated by H.R. 1242. These true commercial nonprofits are entitled to pay the cost of doing business every bit as much as any other for-profit entity in the marketplace.

With that comment, I will conclude my remarks and we certainly are free to respond to any questions.

Thank you very much.

[The statement of Mr. Rector follows:]

STATEMENT OF JOHN M. RECTOR

BEFORE THE HOUSE WAYS & MEANS

SUBCOMMITTEE ON SELECT REVENUE MEASURES

MAY 13, 1987

Mr. Chairman, Members of the Subcommittee*:

I am John M. Rector. I serve as General Counsel and Vice President of Government Affairs for the National Association of Retail Druggists.

The National Association of Retail Druggists represents the owners of nearly 30,000 independent pharmacies, where more than 75,000 pharmacists dispense 70 percent of the nation's prescription drugs. Together, they serve 18 million persons daily and provide 82 percent of Medicaid pharmaceutical services. Over 60 percent of NARD's members provide home health care pharmacy services.

NARD members are primarily family businesses. They have roots in America's communities. The neighborhood independent druggist typifies the reliability, stability, yet adventuresomeness that has made our country great.

As owners, managers and employees of independent pharmacies, our members are committed to legislative and regulatory initiatives designed to provide them a fair chance to compete. We appreciate the opportunity to appear before the Subcommittee to present our recommendations.

Competition in retail pharmacies is alive and well. Competition is an incentive for efficiency and the price competition in retail pharmacy is typically greater than can be found among other providers of health services and products.

We welcome competition and appear today to assist in the effort to assure that retail competitors confront one another on a level playing field.

We strongly endorse H.R. 1242, the "Interstate Sales Tax Collection Act of 1987", which would eliminate judicially imposed restrictions on the power of the states to collect taxes on interstate mail order sales.

In 1967, the U.S. Supreme Court in National Bellas Hess v. Illinois Department of Revenue in effect exempted out-of-state mail order businesses from the obligation of collecting taxes from the buyers of mail order goods and remitting the revenue to the home state, and/or city or local jurisdiction of the purchaser of the out-of-state mail order products.

In effect, such sales have become defacto tax exempt: To the detriment of our members and other retailers who must reflect the tax due in the cost of products and must collect the tax for state and local jurisdictions, and to the detriment of the governmental jurisdiction that are deprived of additional revenue. This defacto tax exempt status yields an advantage to untaxed mail order firms ranging from 2.5 to more than 8 percent depending on the jurisdiction involved.

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* Charles B. Rangel (D-NY), Chairman
MAJORITY: (7-D) Representatives Rangel, Ronnie G. Flippo (AL), Byron L. Dorgan (ND), Barbara B. Kennelly (CT), Michael A. Andrews (TX), Fortney H. Stark (CA), William J. Coyne (PA)
MINORITY: (4-R) Guy Vander Jagt (MI), Raymond J. McGrath (NY), Judd Gregg (NH), Hank Brown (CO)

As mentioned at the outset, our members dispense 70% of all prescription drugs in the United States. Recent reports indicate that prescription drugs acccunt for 60% (41.6 to 78.5%) of a typical NARD member's sales volume. Of course, as you are all familiar, the balance of our members' sales volume includes products such as over the counter drugs, health and beauty aids, sundries, greeting cards, gifts and related products.

Additionally, more than 50% of our members are involved with the sale or rental of home health care products ranging from high tech parenteral products to walkers. In all these product categories, we are confronted by profit and commercial nonprofit mail order competitors. Even a few nonprofit hospitals have entered the mail order drug business.

Most of the current focus in our industry is on mail order dispensing of prescription drugs. These tax exempt competitors (via defacto Bellas Hess or commercial nonprofits) are engaging in costly promotional efforts, in part made possible because they are able to evade state and local taxes. These interstate mail order businesses similarly are attempting to evade the application of state pharmacy practice and other public health laws.

In fact, the subcommittee on Oversight and Investigations of the Energy and Commerce Committee in its April 1986 report Dangerous Medicine recommended (at page 8) that the Congress should:

> "Closely examine the mail order dispensing of pharmaceuticals to determine whether or not the public health risks of this growing practice are reasonable."

We support H.R. 1242 principally because there should be a level playing field in the retail drugstore marketplace. We heartily endorse the comments of the Multistate Tax Commission on the more technical and general need for H.R. 1242.

Commercial Nonprofits

We suggest that the subcommittee include commercial nonprofits within the definition of "retailer engaged in business in that state". We are aware that Chairman Rostenkowski and Oversight Subcommittee Chairman Pickle have made the revenue loss associated with the activities of commercial nonprofits a high priority for the 100th Congress. We recommend that such concerns be addressed in this legislation. The activities of commercial nonprofits are not substantially different from those for profit companies in the mail order retail drug marketplace. Both sell products available from commercial, for profit companies, our members, on a routine basis and routinely do not pay state and local taxes.

The AARP Pharmacy Services and the Arthritis Foundation are prototypical examples of commerical nonprofits in the mail order retail drug marketplace. They pitch savings and drugs at "prices below retail". Of course, exemption from state and local tax is just one of many subsidies they enjoy. AARP, for example, receives an annual federal postage subsidy of approximately $6,500,000 which is used to promote its retail pharmacy as the number one benefit for AARP members. Especially revealing is that commercial nonprofits tend to focus activities in state with the highest tax rates.

Whether the advantage for tax evasion by profit or commercial nonprofits involved with mail order is 2.5 or 8%, it can be a critical competitive advantage in our marketplace where the net profit before taxes averages 2.8% of total sales. Each of these competitors enjoys the advantages of our competitive marketplace and should pay their share of the freight including the same taxes as other entrepreneurs. Just as the point is made with regard to foreign trade, all competitors in the marketplace should confront each other on a "level playing field". For any segment of the market to enjoy artificial advantages over its competitors strikes at the very foundation of the new enterprise system. H.R. 1242 will help achieve this goal.

There is no doubt that the increase in mail order sales has diverted sales from members of the National Association of Retail Druggists who contribute service, convenience, property taxes, and charitable contributions to their communities. For the long-term survival of these and other small businesses, we urge you to put mail order sales on the same state and local tax basis as any other business. You can help keep small business and our local communities healthy by extending the taxing prerogative of the states to mail order sales.

On behalf of the Officers, Executive Committee, and members of the National Association of Retail Druggists, we thank you for the opportunity to appear and participate in the formulation of appropriate federal legislation on this matter.

Mr. DORGAN. Thank you very much for your testimony.

The Chair would ask Mr. Andrews to inquire.

Mr. ANDREWS. I have no questions.

Mr. DORGAN. Mr. Pickle?

Mr. PICKLE. I have no questions, but I appreciate your comment about the tax-exempt organizations. If you have any specific suggestions for my committee, I would be glad to have them.

Mr. DORGAN. Let me just indicate to the panel that I had an opportunity to look through your testimony last evening and I think you portray for this committee in a very real way the difficulties that Governor Thompson was trying to express and I tried to express earlier in the committee hearing of trying to compete in a game where the rules are not quite fair.

This is not a situation where the rules are not fair because the mail order seller or the television direct sales people have gone out to say we do not want to collect the tax. By and large they are stuck in a situation at this point where the Supreme Court case has described a certain jurisdiction and the activity that is increasing these days falls outside of that jurisdiction, that is, the mail order sales area.

I find that many direct sellers are not touting the lack of sales tax for the customer as one of the advantages. Some are. I have seen ads. In fact, I have one here that is a good example of it: "Buy from us and you can avoid paying the local tax." So it does happen.

On the other hand, I think all of you will recognize that there are a good many responsible direct sellers out there who are not marketing on that basis. They are marketing and trying to sell a product, and I do not think any of you here are saying that is an inappropriate way of doing business. It is a legitimate way of doing business and will be with us for some time and perhaps will even grow.

I think what I hear you saying in your testimony is you hire the employees, you buy the building or rent the building, you maintain the inventory, and it is fundamentally unfair that when you make the sale you are required to charge that customer the sales or use tax, but when your competitor makes the sale in a direct selling mode they are not required to do the same.

I think the testimony you have offered us in detail is very descriptive of the problem, and I just want to thank all of you for that description.

I would like to just ask one other question. You mentioned, Mr. Plunkett and Mr. Chesnick, you have mentioned the significant decrease, for example, in furniture dealers. I think you cited the yellow pages, the advertisements in the yellow pages as decreasing from 23,000 to 16,000, roughly in that area.

Mr. PLUNKETT. Yes, sir.

Chairman DORGAN. My assumption is that that cannot be laid at the doorstep of this tax problem, but the tax problem is a contributing factor, that is it is one in a series of steps that probably results in changing patterns of selling in this country. How would you describe the tax consequence in the whole strata of things that might affect how one sells?

Mr. PLUNKETT. Obviously, a recession in home building in the early eighties was also a contributing factor in the diminishing

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number of home furnishings stores. There was also a consolidation likely of smaller stores that are now being taken over or placed out of business by the event of large warehouse-type stores, Levitts and Wicks and so on.

However, I would say at the higher end of the home furnishings business, the direct sellers have had a very real impact and I think that that affected about 25 or 35 percent or siphoned off 25 or 35 percent of the sales from higher-end furniture home furnishings stores and department stores.

Mr. DORGAN. Does anyone else on the panel want to add to those comments?

Mr. HAUSMAN. Mr. Dorgan, Mr. Hechtman would like to offer a clarification of an answer that he made to you.

Mr. DORGAN. All right.

Mr. HECHTMAN. I just wanted to clarify that Circuit City's call-in phone order service here in Washington never was designed to offer a sales tax advantage to consumers in Virginia, the District or other States, but rather as a service to consumers who are unable to reach our stores. It is not something that we actively promote, nor are we really aware that customers would respond purely to the offer for the purpose of savings sales tax, but it brought to the fore the tremendous consumer awareness of the savings available for purchases made in this fashion and aroused our interest in the overall issue.

Mr. DORGAN. Thank you very much for that clarification.

The Chair would like to thank the entire panel for what I think is excellent information on this subject, and we appreciate your being here. The record will remain open if anyone would wish to provide us with other information.

Next, the Chair would ask the panel members to come forward on the panel that comprises the Honorable Elroy M. Hefner, State senator from Nebraska; the New York State Tax Department, represented by Roderick C. W. Chu, commissioner; Sue Martin, commissioner of revenue, State of Michigan; Wade Anderson, Executive Council for State Comptroller, representing the Comptroller of Public Accounts of Texas; and Freda Miklin, Tax Compliance Office, city of Denver, Colo. representing the National League of Cities.

The Chair would like to welcome the entire panel to the Ways and Means Committee and the subcommittee.

The Chair would call on Congressman Daub, who sought recognition.

Mr. DAUB. Mr. Chairman, thank you very much for the accommodation. I seek recognition to introduce the Honorable Elroy M. Hefner, a distinguished member of our unicameral State senate who comes from northeast Nebraska. Senator Hefner has actually introduced three very significant pieces of legislation that are germane to the hearing. His great persistence resulted in his last effort being enacted and signed by the Governor during this session. Senator Hefner will add a great deal, I am sure, to the information you are seeking, and it is my distinct privilege as a member of the committee to have him before you today.

Chairman DORGAN. Thank you, Mr. Daub.

We will recognize the panel in order as scheduled on the agenda, but I would next like to recognize Congressman Pickle, who would like to introduce a member of the panel who, I might add, is a long-time friend of mine as well.

Mr. PICKLE. Well, Mr. Chairman, you are very kind to yield to me and I appreciate your courtesy.

I came today so I could present my good friend Wade Anderson, from Austin, Tex., a member of this panel. We have been family friends for many a year. He is the executive counsel for our State comptroller, Mr. Bob Bullock. Mr. Anderson has been very active in appearances before the Multi-Tax Commission and before the National Association of Tax Administrators on mail order issues. He is a national expert.

Also, he represents our State comptroller and today he is the voice of the State of Texas on this issue, and I submit to you that his views deserve serious consideration because Bob Bullock is one of the outstanding comptrollers of the Nation, and Mr. Anderson is also an outstanding expert in his field. So I wanted to personally welcome him to this panel today.

Thank you, Mr. Chairman.

Mr. DORGAN. Mr. Pickle, thank you very much, and might I say that I have known Mr. Anderson for probably 15 years and I know him to be an outstanding expert in the field of taxation. Of course, everyone from Texas is described as outstanding, but welcome, Mr. Anderson.

The Chair would next like to recognize our colleague, Congresswoman Pat Schroeder is with us also to introduce a panel member from her own State.

Ms. SCHROEDER. Thank you, Mr. Chairman and members of the committee.

I am very honored to be able to introduce Freda Miklin, who is the tax compliance officer for the city of Denver. She is going to be testifying on H.R. 1242 and H.R. 1891, that really is critical legislation to both our city of Denver and cities across the Nation and therefore she has been honored to represent the League of Cities and is one of our great treasures.

I am not a cosponsor of either of these bills, because they really do not address the needs of cities like Denver, and I think the issue of taxes on mail order catalogs is very important to Denver because we could lose up to $2 million in tax revenues from our base if the bills remain intact, and I want to tell you that a city like ours is in almost tremendous economic straights, that $2 million could be very critical for important local services.

So I am really honored that she is here speaking on these things and I am very pleased that the committee would let me introduce her and we are also pleased that the League of Cities saw her testimony to be so critical that she is representing many other cities also.

Thank you.

Mr. DORGAN. Congresswoman Schroeder, thank you very much for appearing and introducing to us Freda Miklin, and we will be anxious to hear her testimony.

We would like to begin the panel by calling on the Honorable Elroy Hefner, State senator from Nebraska.

Senator Hefner?

STATEMENT OF HON. ELROY M. HEFNER, SENATOR, NEBRASKA STATE LEGISLATURE

Senator HEFNER. Thank you, Mr. Chairman.

Mr. DORGAN. Let me point out that your entire statement will be made of the permanent record and we would appreciate it if you would summarize it.

Mr. HEFNER. Thank you.

Mr. Dorgan and members of the subcommittee, my name is Elroy Hefner, and I am a State senator in the Nebraska unicameral legislature.

The Nebraska Legislature passed Legislative Resolution 123, which states our endorsement of this bill, H.R. 1242. This resolution is included in my written statement and now I will summarize that written statement.

In the past 3 years, I have sponsored legislation in the Nebraska Legislature to collect sales and use tax on taxable items sold through the mail to Nebraska residents by out-of-state merchants. I have sponsored this legislation because I believe it is unfair to in-state merchants who collect and remit this tax.

In-state merchants operate at a disadvantage if they must collect a tax on the merchandise they sell, when their competing interests out-of-State do not. This puts States in the awkward position of placing a disadvantage on residents of their own State, and giving a break to out-of-State interests.

In the State of Nebraska, we prefer making the business climate a fair, competitive arena. The present restrictions on States which prohibit them from collecting sales and use taxes from out-of-State merchants prevent them from realizing a fair, competitive system. Unfortunately, from a practical perspective, it is impossible for a State to collect the tax on items marketed and purchased through the mail under present Federal law. Many States rely heavily on sales and use taxes for revenue, Nebraska included. It is therefore necessary that Congress pass legislation which will assist States in the collection of sales and use taxes on items purchased through the mail.

This bill, H.R. 1242, will help solve this problem. It is fast becoming a common practice throughout the Nation to use catalogs, cable TV advertisements, toll-free telephone order numbers, credit cards and direct-mail advertising for the purchase of goods from out-of-State to be delivered to the resident buyer.

Continuing changes in communications indicate the mail order business will continue to boom. In fact, it is now one of the fastest growing industries in the Nation. The Nebraska Legislature passed L.B. 304, the bill that I sponsored, earlier this year. The Governor signed the bill and it becomes effective on October 1, 1987.

L.B. 304 amends the definition of "engaged in business in this state" to include any regular soliciting of sales in Nebraska through Nebraska advertising media. L.B. 304 seeks to establish a nexus between out-of-State vendors and the State, thereby giving the State the legal and practical authority to collect sales and use taxes by requiring these vendors to remit the tax.

The attorney general of Nebraska issued an opinion on L.B. 304, indicating that parts of it may be unconstitutional, but the final determination could be made by the courts, or the final determination I believe could be made in a much simpler and better fashion, the passage of H.R. 1242.

H.R. 1242 clears the way for Nebraska and other States to collect taxes which are due to the States. It would also avoid court tests which could have results which neither the States nor Congress would like.

One important and efficient provision of H.R. 1242 is the collection of informational returns by the IRS indicating the amount of sales in the State by each company. This will allow the Nebraska Department of Revenue to connect to the IRS information by computer to process the amount of taxes due.

In the meantime, States will continue to pass legislation in a piecemeal fashion. This is an inconvenience to vendors who are affected by States which may have varying quirks in the law and also different sales tax rates. States will continue to pass legislation such as the one that I have sponsored because of the revenue needs, but just importantly because they believe it is unfair to their instate vendors not to do so.

It has been estimated by the Advisory Committee on Intergovernmental Relations that Nebraska loses up to an estimated $13 million annually. All States combined lose an estimated $1.5 billion each year.

Again, the simplest and best solution is for Congress to pass legislation to allow States to collect the taxes which they are entitled to.

I commend you, Mr. Dorgan and some of your other committee members for sponsoring this legislation, and I urge the committee's favorable consideration of the bill.

If you have any questions, I would be real happy to try and answer them.

Thank you.

[The statement of Senator Hefner follows:]

Nebraska State Legislature
50th Anniversary of the Unicameral
1937 1987

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Ninetieth Legislature

COMMITTEES

Vice Chairman: Revenue
Agriculture
Business and Labor
Legislative Council

Testimony of State Senator Elroy M. Hefner, of Coleridge, Nebraska, before the Subcommittee on Select Revenue Measures, Committee on Ways and Means, United States House of Representatives, in support of HR 1242.

May 19, 1987

In the past three years I have sponsored legislation in the Nebraska legislature to collect sales and use tax on taxable items sold through the mail to Nebraska residents by out-of-state merchants. I have sponsored this legislation because I believe it is unfair to in-state merchants who collect and remit this tax. In-state merchants operate at a disadvantage if they must collect a tax on the merchandise they sell, when their competing interests out-of-state do not. This puts states in the awkward position of placing a disadvantage on residents of their own state, and giving a break to out-of-state interests. In the State of Nebraska, we prefer making the business climate a fair, competitive arena. The present restrictions on states which prohibit them from collecting sales and use taxes from out-of-state merchants prevent them from realizing a fair, competitive system. Unfortunately, from a practical perspective, it is impossible for a state to collect the tax on items marketed and purchased through the mail under present federal law. Many states rely heavily on sales and use taxes for revenue, Nebraska included. It is therefore necessary that Congress pass legislation which will assist states in the collection of sales and use taxes on items purchased through the mail.

It is fast becoming a common practice throughout the nation to use catalogs, cable TV advertisements, "800" telephone order numbers, credit cards, and direct-mail advertising for the purchase of goods from out-of-state to be delivered to the resident buyer. Continuing technological changes in communications indicate the mail order business will continue to boom. Ordering goods by computer is quickly becoming a reality. These sales are taxable under Nebraska law---despite the widely held misconception they are not. The state is unable to collect the tax. Sales made through the use of these methods occupy a "tax-free" zone.

The barrier to tax collection of mail-order and direct-sales stems from the 1967 United States Supreme Court decision, National Bellas Hess, Inc. v. Illinois Department of Revenue, 386 U.S. 753. This case held that a state could not require an out-of-state mail order vendor to collect and remit the state's sales or use tax on sales made to consumers in that state if that firm did not have some minimum linkage or nexus in the taxing state. The Court ruled that any such requirement violated the due process and commerce clauses of the United States Constitution. This decision continues to control any tax collection attempts made by the states in the face of phenomenal growth in the direct-mail marketing industry. Congress holds the key to allow states to collect this tax. HR 1242 is that key.

The Nebraska Legislature passed LB 304 on February 25, 1987. The Governor signed the bill on March 2, 1987, but it becomes operative on October 1, 1987, the beginning of a tax quarter. LB 304 amends the definition of "engaged in business in this state" to include any of the following:

1. "Soliciting retail sales of tangible personal property from residents of this state on a continuous, regular, or systematic basis by means of

advertising which is broadcast from or relayed from a transmitter within this state or distributed from a location within this state."

2. "Soliciting orders from residents of this state for tangible personal property by mail, if the solicitations are continuous, regular, seasonal, or systematic and if the retailer benefits from any banking, financing, debt collection, or marketing activities occurring in this state or benefits from the location in this state of authorized installation, servicing, or repair facilities."

3. "Being owned or controlled by the same interests which own or control any retailer engaged in business in the same or similar line of business in this state."

4. "Maintaining or having a franchisee or licensee operating under the retailer's trade name in this state if the franchisee or licensee is required to collect the tax under the Nebraska Revenue Act of 1967."

LB 304 seeks to establish a nexus between out-of-state vendors and the state, thereby giving the state the legal and practical authority to collect sales and use taxes by requiring these vendors to remit the tax.

On February 17, 1987 the Attorney General of the State of Nebraska issued an opinion concerning the constitutionality of LB 304. The opinion stated in part: "With respect to the proposal to expand the definition to reach the solicitation of retail sales through advertising broadcast from a transmitter in the state, or distributed from a location in the state, these facts alone would appear to be insufficient to justify either sales or use tax collection obligations on out-of-state sellers. The Supreme Court has never held that mere advertising alone is sufficient to satisfy the due process requirement based upon the connection between the state and the person or property or transaction it is seeking to tax. Similarly, as there is no controlling precedent as to the sufficiency of the contacts pertaining to the proposed amendments to include within the definition 'Being owned or controlled by the same interests which own or control any retailer engaged in business in the same or similar line of business in this state', or 'Maintaining or having a franchisee or licensee operating under the retailer's trade name in this state...', these provisions may also be constitutionally suspect as to the adequacy of the nexus existing under such circumstances."

The opinion went on to state: "The final provision of LB 304 seeks to expand the definition of 'engaged in business in this state' to cover the solicitation of orders from Nebraska residents by mail, if done on a 'continuous, regular, seasonal, or systematic' basis, and '... if the retailer benefits from any banking, financing, debt collection, or marketing activities occurring in this state or benefits from the location in this state of authorized installation, servicing, or repair facilities.' As to the imposition of sales tax liability under these circumstances, we believe this provision is not drawn with the specificity required to fall within the standards for constitutional purposes set forth by the Supreme Court in this area. As to the imposition of a use tax collection obligation under these circumstances, we believe this particular provision would survive constitutional attack, as it appears to require contact with the state beyond mere solicitation and mailing of orders into the state, as involved in National Bellas Hess, Inc., supra, by requiring that the seller also receive certain tangible benefits from the taxing jurisdiction in order to trigger the obligation to collect and remit used taxes from purchasers. It must be remembered, however, that the validity of the application of such a requirement depends primarily on the facts involved in a particular situation, and that the court decisions in this area do not provide a broad, definitive standard which would permit the application of a 'bright-line' test as to the constitutionality of legislation of this nature."

The opinion also stated: "Upon review of the series of Supreme Court decisions in this area, it is apparent that the determination of whether sufficient nexus exists to justify imposition on an out-of-state seller of the obligation to act as the state's tax collection agent is a question answered primarily on a case-by-case basis. The Court has not pronounced a definitive standard by which to determine whether an out-of-state seller has engaged in the requisite level of local activity, but has instead chosen to consider each case on its particular facts."

The Attorney General indicates there is no sure indication of whether the provisions will pass constitutional tests. These provisions have not yet been tested. The final determination could be made by the Courts. Or the final determination could be made in a much simpler fashion---the passage of HR

1242. HR 1242 clears the way for Nebraska and other states to collect taxes which are due to the states. It would also avoid court tests which could have results which neither the states nor Congress would like.

In the meantime states will continue to pass legislation in a piecemeal fashion. This is an inconvenience to vendors who are affected by states which may have varying quirks in their laws. States will continue to pass legislation such as LB 304 because of their revenue needs, but just as importantly, because they believe it is unfair to their in-state vendors not to do so. It has been estimated by the Advisory Committee on Intergovernmental Relations that Nebraska loses up to an estimated $13 million annually. Again, the simplest solution is for Congress to pass legislation to allow states to collect the taxes which are due them.

LEGISLATIVE RESOLUTION 123

Introduced by Hefner, 19; V. Johnson, 8

WHEREAS, the commerce clause of the Constitution of the United States reserves to Congress the power to regulate and control interstate commerce; and

WHEREAS, the subcommittee on Select Revenue Measures, Committee on Ways and Means, United States House of Representatives, will hold a public hearing on HR 1242, the Interstate Sales Tax Collection Act of 1987, on May 13, 1987; and

WHEREAS, HR 1242 would authorize states to require retailers to collect sales and use taxes on interstate sales and require such retailers to file information returns with the Internal Revenue Service for the purpose of assisting states in the collection of such taxes; and

WHEREAS, the Legislature passed LB 304 on February 25, 1987, and the Governor signed the bill on March 2, 1987; and

WHEREAS, the purpose of LB 304 is to broaden the state's authority in collecting sales and use taxes

on mail order sales; and

WHEREAS, it is unfair to businesses operating within the state to collect and remit sales and use taxes while out-of-state competition doing business through the mail does not collect or remit such taxes; and

WHEREAS, HR 1242 would greatly assist the State of Nebraska in pursuing the goals of LB 304; and

WHEREAS, the Advisory Committee on Intergovernmental Relations has estimated that under the present scheme Nebraska may be losing up to an estimated 13 million dollars annually.

NOW, THEREFORE, BE IT RESOLVED BY THE MEMBERS OF THE NINETIETH LEGISLATURE OF NEBRASKA, FIRST SESSION:

1. That the Legislature encourages the United States House Ways and Means Committee and its Subcommittee on Select Revenue Measures to support HR 1242.

2. That the Legislature encourages Congress to swiftly adopt the provisions of HR 1242.

3. That a copy of this resolution be presented to United States Representative Charles B. Rangel, Chairperson of the Subcommittee on Select Revenue Measures at the public hearing on HR 1242.

4. That copies of this resolution be sent to

LR 123 LR 123

Representative Dan Rostenkowski, Chairperson of the House Ways and Means Committee, Representatives Byron L. Dorgan, Hal Daub, and Sander Levin, sponsors of HR 1242, and Representatives Virginia Smith and Doug Bereuter.

William E. Barrett

PRESIDENT OF THE LEGISLATURE

I, Patrick J. O'Donnell, hereby certify that the foregoing is a true and correct copy of Legislative Resolution 123, which was passed by the Legislature of Nebraska in Ninetieth Legislature, First Session, on the eighth day of May, 1987.

Patrick J. O'Donnell

CLERK OF THE LEGISLATURE

Mr. DORGAN. Mr. Hefner, thank you for your testimony and for traveling here from Nebraska to express to us the interests of the State Legislature.

Next we will hear from Mr. Roderick Chu, the commissioner of the New York State Tax Department.

Mr. Chu.

STATEMENT OF RODERICK G.W. CHU, COMMISSIONER, NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE

Mr. CHU. Mr. Chairman and members of the subcommittee, I am Roderick G.W. Chu, commissioner of taxation and finance for the State of New York. Thank you for the opportunity to testify today on a matter of great importance to my State, to our taxpayers and to our merchants.

As you have learned, the Supreme Court's *National Bellas Hess* decision sharply limited the States' ability to collect the sales and use taxes they are legally owed. A State cannot require an out-of-State retailer to collect sales or use taxes unless the company has a physical presence in the State or makes sales through local agents. The State's only option is to urge its residents voluntarily to report and pay a use tax on each out-of-State purchase. As you might imagine, consumers do not generally comply.

In short, the *Bellas Hess* decision has allowed mail-order businesses and other direct marketers to operate tax-free across State lines. Governor Thompson and others have eloquently addressed the massive and growing concern the States have with tax-free mail order sales, so I will not repeat these points.

But our concerns do not rest solely with traditional direct marketing merchants. Some retail stores near State borders encourage customers to evade taxes by crossing State lines and having merchandise shipped to them at home. Indeed, the *Bellas Hess* loophole is being exploited in multimillion dollar criminal tax evasion schemes.

False shipping records have been used by some prestigious retailers to give their clients an illegal sales tax discount. Five already have pleaded guilty and are paying back over $10 million to New York State. Other jewelers, furriers and furniture stores have been indicted and are awaiting trial. While these merchants are not primarily mail-order firms, they have taken advantage of the loophole granted mail-order sales to evade massive amounts of taxes on luxury merchandise, a loophole you would close with your legislation.

In response to Mr. Chapoton's concerns, let me note that the States have not sat idly by. We have made efforts in the past twenty years to combat this growing evasion of sales and use tax. As noted in my prepared testimony, some States have attempted to litigate test cases to produce new judicial standards. Others, like New York, have entered into agreements to work closely with neighboring States.

These approaches, however, have severe limitations. Congressional action is indeed needed. As one of the drafters of legislation proposed by the National Association of Tax Administrators, I am pleased that you, Mr. Chairman, and Mr. Brooks have agreed to

merge your bills. Any Federal bill which is to address effectively the growing problem of tax-free interstate sales must contain provisions to expand the taxing jurisdiction of the States, yet at the same time limit the impact on small businesses and simplify administrative requirements for those merchants newly included under the bill.

Before I close, let me address one of the concerns raised by Congressman Gregg who raised the specter this morning of 46 State or 6,500 local auditors jetting into each mail order merchant. One simple fact is that each of my auditors generates about $750,000 in revenue a year. They cannot do so by jetting around to harass honest taxpayers or those who should pay a few thousand dollars in tax.

We certainly look forward to working with other States as we have done in the past to conduct joint audits of such vendors in order to minimize burdens on vendors and certainly to maximize our own productivity.

Mr. Gregg's concern may make good theater, but it is fiction and not reality.

In conclusion, by enacting the legislation you are considering, Congress will enable the States to collect taxes which are now owing and due, a fair share of tax from those who benefit from the services our States provide in the least burdensome way possible for our taxpayers, our merchants and our State governments.

Thank you.

[The statement of Mr. Chu follows:]

TESTIMONY BY RODERICK G. W. CHU
COMMISSIONER OF NEW YORK STATE DEPARTMENT OF TAXATION AND FINANCE
HOUSE SUBCOMMITTEE ON SELECT REVENUE MEASURES
REPRESENTATIVE CHARLES RANGEL, CHAIRMAN
MAY 13, 1987, 10 A.M.
ROOM 1100
LONGWORTH HOUSE OFFICE BUILDING
ON
H.R.1242

Mr. Chairman, Members of the Subcommittee: I wish to express my appreciation for the opportunity to speak before you this morning on a matter of great importance.

Forty-five of our 50 states plus the District of Columbia impose sales and use taxes and are struggling to deal with the problem of inadequate state jurisdiction in the area of sales and use taxation. H.R.1242 is one of several bills attempting to solve the problem. Other bills are:

H.R.1891	(Brooks, Texas)
S.1099	(Cochran, Mississippi)

These bills seek to identify areas of taxing authority which will provide for fair tax treatment of both in-state and out-of-state vendors and for simplified administration of the tax laws. In addition, these bills, by updating jurisdictional standards, help stem a loss of sales and use tax revenue estimated at more than $1 billion annually.

CURRENT SITUATION

As you know, the United States Supreme Court, in its 1967 National Bellas Hess decision, sharply undercut the revenue base of the states by limiting their ability to enforce sales and use tax laws. We are now permitted to impose tax collection requirements on out-of-state vendors only if they have a physical presence in our state or make sales through local agents. Where these conditions do not exist, a state can only require that resident consumers pay a compensating use tax on their purchases.

In our system of voluntary tax compliance, tax administrators are required to ask each of our residents to voluntarily come forward and report the use tax they owe on such purchases. Regrettably, enforcement of the use tax is one of the great unsolved problems of tax administration: How can I as a tax administrator determine that John Doe purchased a shirt by mail order from L.L. Bean? Since I do not now have the right to conduct an audit of mail-order firms not present in my state, I cannot acquire the names and addresses of the consumers who received shipments of goods in New York. As you can imagine, without an effective means of enforcement against mail-order vendors, consumers also will assume compliance may not be necessary.

We are drawn to the conclusion that the laxity in compliance and confusion resulting from the Bellas Hess decision are encouraging the citizens of the United States to not pay taxes. Why then do we wonder why we have a $100 billion federal problem with the "underground economy," with over-zealous methods of sheltering from taxes and with a plethora of schemes designed to defraud the federal, state and local governments out of taxes which are rightfully owed? Bellas Hess is not, of course, the only reason, but it is a wrong that should be corrected, and I am hopeful that it will be.

REVENUE LOSS IMPACT

The impact of restricted taxing authority is severe. The loss of revenue is estimated at over $1 billion annually. It is especially onerous in light of the trend over the last several years of the federal government reducing grants and aid to the states and municipalities. There seems to be little doubt that this trend will continue and perhaps dramatically accelerate.

In light of this fact, it is ludicrous that we permit the courts to establish by default arbitrary obstacles that make it impossible for the states to fully collect their sales and use taxes. The loss to New York State is pegged at $100 million for the four percent state tax alone.

In addition, this tax-exempt direct marketing industry is growing much faster than traditional local retailing. The volume and types of mail-order business have increased sharply and their means of exploiting local markets have changed drastically. Television advertising goes directly into every home in a state and toll-free 800 numbers, national credit cards, and cable TV auctions and selling services invite our citizens to make purchases which are beyond the reach of our tax laws. If you have experienced the electronic department stores and carnival-like "auction" programs now a regular feature on cable television, you can appreciate not only how much things have changed, but also how much more they are going to continue to change.

COMPETITION IMPACT

But loss of tax revenues is not the only problem caused by the situation we face with the mail order industry. The business community faces a problem with competitive unfairness in the marketplace. Both large and small retailers who have physical presence in a state are required to collect sales tax on their catalog sales in all states in which they do business. Why should some other firms have an unfair business advantage of being able to compete with those stores by not having to collect sales tax in any state except where their order facility is located? In the State of New York, the "discount" which such a firm could offer solely on the basis of not taxing the sale would amount to as much as 8¼%. To force any firm to compete under these conditions may well be the difference between business success and failure.

The problem is not isolated to interstate mail-order business. Local retailers in each of our states face a similar unfair disadvantage in trying to attract customers from whom they must collect the sales tax, when those same consumers can avoid sales tax and use tax by shopping with mail-order establishments or crossing states lines and having merchandise shipped to them at home.

Why then do we penalize the reputable and law-abiding businesses who operate within our borders by permitting such a miscarriage? The reason escapes me, and I think it is time we corrected it.

TAX EVASION IMPACT

Another concern which may be even more compelling is that the Bellas Hess decision is influencing the citizens of each state to violate the laws of that state. Imagine the temptation to the average citizen purchasing a product through a catalog operation which does not collect the sales tax, not to report that tax when the vendor does not attempt to collect the tax. The correct thing for the citizen to do in such a situation would be to voluntarily fill out a use tax form and submit it with the tax to the state in which he or she is a resident. The temptation to evade this tax is seductive, and there is little doubt that these taxes will not be collected unless the states' powers are restored, allowing us to prove to the public that the tax law can and will be enforced.

In the past two years, the evidence of tax evasion has become even more disturbing. We now have proof that the Bellas Hess principle is consciously being used to mask multi-million dollar criminal tax evasion schemes. False shipping records have been used by some of America's more prestigious retailers in order to give their clients a sales tax discount. Cartier, Bulgari, Van Cleef and Arpels, Christie Brothers Furs, and Ben Thylan Furs have pleaded guilty and are paying back over $10 million to New York State. Several other jewelers, furriers and furniture stores have also been indicted. While the retailers in question are not primarily mail-order firms, as these investigations and prosecutions have proven, they use the special privilege granted mail-order sales to camouflage their criminal activity in their home states.

The irony of this tax problem is that most taxpayers are willing to pay taxes due if they know the tax is due

STATE EFFORTS

The states have struggled to deal with the court imposed constraints. One effort has been to litigate test cases to produce new court standards in light of the changes of the last 20 years. Several states have attempted to take this route. However, it has severe drawbacks.

First of all, it takes a lot of time, effort, and money. Second, it is a very uncertain process. Taxing jurisdictions could well get redefined by the courts in a way difficult to live with for both direct marketers and tax administrators. Finally, a practical problem has arisen. As each test case has been developed so far, after reaching only a state level of appeal, the defendants have consistently dropped their defense, admitted their obligation, and started collecting the tax.

Another solution would be to enter into state-by-state agreements such as New York has recently done with New Jersey and Pennsylvania. Although these agreements are aimed at countering border sales tax evasion, they could apply to mail order business between the states as well. Since inauguration of the New York/New Jersey agreement one year ago, over 3,400 vendors on both sides of the river have voluntarily signed up to collect the other state's taxes. Unfortunately, most direct marketing firms have chosen not to participate.

There are other problems with using state-by-state agreements to solve the mail order problem. First, it will take a long time to secure such agreements. Second, there are five states without sales and use taxes. Third, some states would not get proportionate or productive benefits for the energies they would have to expend. For example, I might try to persuade the tax officials in the home state of a vendor to conduct an audit of the company and supply me with the names and addressed of customers in my state. Such an effort would require my sister states to expend substantial resources in getting information for my state while not producing any additional revenue for their own states' treasuries. In addition, with millions of vendors in the United States and 17 million New Yorkers, this represents an incredibly difficult means of collecting these taxes.

Finally, such a solution could prove especially onerous to the direct marketing industry whose compliance we seek. They would have two choices. They could voluntarily collect sales taxes including all the various local rates and requirements, or they could refuse and see their soon-to-be-former customers hit with use tax bills for taxes, interest, and penalties. Even though the use of "customer list" programs are not the most productive auditing programs we have, interest in this type of enforcement activity through bi-state agreements is spreading beyond our neighboring states.

However, because of the drawbacks of these two solutions-- a test case or state agreements-- we have before us legislation to solve the problems through Congressionally established jurisdiction standards.

LEGISLATIVE PROVISIONS

The National Association of Tax Administrators (NATA) has prepared draft legislation, which, like H.R.1242, addresses the essential concerns.

The NATA proposal contains several key provisions which should be addressed in any bill designed to solve the revenue, fairness and administrative simplicity issues. These are:

- The responsibility to collect and pay sales and use taxes should be expanded to include out-of-state vendors who do substantial advertising or other systematic solicitation of customers in a state on deliveries made into that state. (H.R.1242 goes part way in achieving this purpose, but does not restore sufficient jurisdiction to insure that fair competition will occur, nor would it provide expected revenue.) /1

/1 Most of jurisdictional redefinition in Section two of H.R.1242 includes conditions which we believe are already taxable, such as rental of tangible personal property or servicing of goods sold; or conditions which are easily avoided, such as local advertising distribution, banking or marketing.

- A de minimis rule should guarantee that small businesses and businesses selling nominal amounts of goods into a state are not burdened with tax collection and filing requirements. Only businesses of a size that could reasonably be expected to computerize or understand individual states requirements should be included. (The NATA bill uses ACIR recommended standards -- companies with annual gross sales of over $12.5 million -- or those selling over $500,000 into any state in a year. H.R.1242 uses one standard of $5 million in annual gross retail sales.)

- In an effort to reduce the administrative burden on business, only one tax rate for each state would be applied. This rate would be the state rate plus the lowest common local rate or a state-legislated statewide local rate. (Both the NATA proposal and H.R.1242 contain uniform rate provisions.)

- To further reduce confusion and bookkeeping difficulties, the vendors newly subject to state tax collection requirements should report taxes on a standard quarterly basis nationwide. (H.R.1242 also provides for additional reporting to the Internal Revenue Service.)

- Finally, the requirement to collect and pay over taxes to the states should be applied only on a prospective basis for these vendors, and should begin after the threshold amounts have been exceeded for a period of time. (H.R.1242 does not address these points.)

As I indicated earlier, the tax commissioners of the 50 states have approved this legislation. And in their meeting last September, the Advisory Commission on Intergovernmental Relations recommended legislation of the type we are proposing.

CONCLUSION

Federal legislation is needed to bring the direct mail and marketing industries under state sales and use tax authority.

The states have molded legislation designed to close the tax base loophole in a way which addresses the major concerns of the businesses which would be required to collect the tax from customers. Simplified reporting, uniform tax rates and de minimis standards are provided for.

While the NATA proposed bill contains the needed provisions, it is suggested that drafters of H.R.1242, H.R.1891 and S.1099 join in a common effort to achieve a federal law as soon as possible.

Mr. DORGAN. Thank you, Mr. Chu, for your testimony.

Next we will hear from Sue Martin, the commissioner of revenue of the State of Michigan.

Ms. Martin.

STATEMENT OF SUSAN WORK MARTIN, COMMISSIONER OF REVENUE, DEPARTMENT OF TREASURY, STATE OF MICHIGAN

Ms. MARTIN. Good afternoon, Chairman Rangel, Mr. Dorgan and members. I am Susan Work Martin, revenue commissioner for the State of Michigan. I am also a member of the National Association of Tax Administrators, the Multistate Tax Compact Executive Committee, and the Great Lakes Compact.

I would like to note just for the record that the Wall Street Journal did a front-page story on the Home Shoppers Network growth today, one of the many direct marketers that are competing against our small businesses.

Just to add a little humor to the session, I would like to note that women do have to suffer the indignity of receiving unsolicited catalogs as I did this week for the fashion conscious larger women. I sure want to be collecting tax from those companies.

Who is the taxpayer? I think we need to be reminded of that. The taxpayer of the sales and use tax is the consumer, it is not the direct marketer. And what is the best way for the consumer to pay this tax? What is in the interest of the Michigan taxpayer or any other State taxpayer?

The fairest, most uniform, easiest manner to collect a sales or a use tax from the consumer in our State of residence is at the point of sale. That is what we want. We want to make it easy for the taxpayers, we want to make it fair, we want to make it uniform and consistent.

Michigan has been actively pursuing out-of-State sales through the Great Lakes Compact and the Multistate Compact. Through the Great Lakes Compact, hundreds of thousands of letters and brochures were mailed to retail companies in Ohio, Indiana, Illinois, Minnesota, and Wisconsin, requesting voluntary registration to collect Michigan sales and use tax. To date, 5,500 applications were requested from out-of-State companies and 1,551 companies have voluntarily registered who do not have nexus in our State to collect and remit use tax on purchases made by Michigan consumers.

In addition, the other compact States, Ohio, Indiana, Illinois, Minnesota, and Wisconsin also have voluntary registrations on the order of 1,500 to 1,800 apiece.

Interestingly enough, of the 1,551 companies that voluntarily registered, 153 were from noncompact States. In other words, those 153 applications indicated a desire by retailers to comply voluntarily and have a level playing field. These companies did not receive a direct mailing from Michigan or other Great Lakes States, but through word of mouth they are making an effort to comply and create a level playing field for fair competition.

We consider this voluntary compliance to be encouraging. The multistate effort is exciting, and we have found overwhelming support from retailers, but it is no substitute for legislation to require

collection of sales or use tax at the point of sale. The Great Lakes States have made it very clear that voluntary collection and registration does not establish nexus for other State taxes in this program. That is a separate issue and determined as it always has been under Public Law 96-272.

The States can work together, however. We have shown that in the Great Lakes. We understand that we must make it easy to file to maximize compliance. The specter outlined today of private jets of thousands of auditors sounds ominous but it is an illusion. States do not have unlimited enforcement resources to harass direct marketers. Contrary to the popular image of tax collectors, we do not even want to harass any taxpayer.

States will greatly benefit by making it easy to comply and therefore will maximize compliance. The State of Michigan is committed to developing a procedure that assures compliance with H.R. 1242 and will not unduly burden retailers. We will work aggressively with other States to develop uniform reporting procedures. We will be prepared to offer individual and immediate assistance to train affected retailers on new reporting requirements.

But the fact is Sears, Roebuck & Co. has been collecting tax on catalog sales in 46 States, all States that have a sales or use tax, since 1941. Is it fair for Sears to compete with Spiegel and others who are not required to collect tax simply because they do not have nexus in that State? We think not. Is it reasonable to believe that Spiegel can administer, and they show in their catalog they can administer and charge differential finance charge rates based on individual State law but they cannot administer and collect different sales and use tax charges? We think not.

Is it fair for small businesses in Michigan to compete directly with untaxed direct marketing prices? Of course not. We agree with David A. Broene of Broene's Furniture Co., Allendale, Mich., who wrote me in response to the Great Lakes Compact, saying:

> Thank you for your letter...we have been very concerned about this problem due to North Carolina furniture outlets * * * we have lost sales strictly because of the difference the sales tax makes. We can compete business-wise, but the 4 percent tax does make a price difference. Hope you continue to pursue this matter.

There are thousands of small businesses like this. To close, Bill Pomeroy, a jeweler in Travis City, wrote in March:

> The State of Michigan probably loses millions upon millions of dollars in State sales tax right now, not to mention the loss of income tax from State merchants who lose business to these people. I sincerely suggest that you wake up and smell the bacon burning.

Thank you.

[The statement of Ms. Martin follows:]

TESTIMONY OF THE
STATE OF MICHIGAN
DEPARTMENT OF TREASURY
COMMISSIONER OF REVENUE
BEFORE THE
HOUSE WAYS AND MEANS SUBCOMMITTEE ON
SELECT REVENUE MEASURES

May 13, 1987

Good day Honorable Chairman Rangel and Committee Members. I am Susan Work Martin, Revenue Commissioner for the State of Michigan. Today I am here to comment on the long awaited and much needed H.R. 1242, the Interstate Sales Tax Collection Act of 1987.

Michigan, a state recognized as a national leader in manufacturing and sales, is losing at least forty million dollars annually in sales and use tax collections due to a national interstate system of retailing. This retail system uses television to market, fills your mailbox with catalogs, and solicits by telephone. As a result of the limitation on collecting sales and use tax placed upon the states by the National Bellas Hess decision, national retailers can avoid state sales and use taxes.

For the State of Michigan, this piece of legislation is of vital importance and ultimate necessity. The passage of this Bill will improve the business climate in Michigan by eliminating unfair competition by out-of-state retailers. Retailers now solicit sales through computers, 800 numbers, televisions ads and auctions, and specialty catalogs. Easy credit is another significant factor which has added fuel to the fire. Nationally recognized credit cards and electronic transfer of funds have made it easy and convenient for consumers to purchase goods anywhere in the country without leaving their home. Contributing to the problem is the recent advent of overnight mail delivery and other advanced and competitive delivery mechanisms. This kind of sales activity creates a gap in sales and use tax collections. Consumers shop for goods at the lowest price. Retailers can effectively reduce the cost of an item by failing to collect sales and use tax. This creates an unfair advantage to the retailers who do not have to collect sales and use taxes for Michigan. This type of "tax dodge" should not be allowed to influence the decision of consumers to purchase goods from Michigan or outstate business. It is anti-competitive and unfair to businesses collecting and remitting sales and use tax. We must have legislation like H.R. 1242 to stop this problem.

In an effort to combat this threatening problem, Michigan has been actively pursuing out-of-state sales through the Great Lakes Compact and the Multistate Tax Compact. Through the Great Lakes Compact, hundreds of thousands of letters and brochures were mailed to retail companies in Ohio, Indiana, Illinois, Minnesota and Wisconsin requesting voluntary compliance on collecting and remitting Michigan Sales and Use Tax. Five thousand five hundred (5,500) applications were mailed out in response to this effort. To date, 1,551 companies have registered. One thousand three hundred and ninety-eight (1,398) from Compact States and one hundred and fifty-three (153) from non-Compact States. We consider this voluntary compliance to be encouraging and have found overwhelming support from retailers, but it is no substitute for legislation to require collection of sales or use tax. The one hundred and fifty-three (153) applications requested from non-Compact state companies also indicates a desire by retailers to comply voluntarily. These companies did not receive a direct mailing from Michigan, but through word-of-mouth they are making an effort to comply and create a "level playing field" for fair competition.

The State of Michigan is committed to developing a procedure that assures compliance with H.R. 1242 will not unduly burden retailers. We will work with other states to develop uniform reporting procedures. The Department of Treasury will be prepared to offer individual and immediate assistance to train affected retailers on new reporting requirements. Sears Roebuck and Co. has been collecting tax on catalog sales since 1941 in all 46 states (four states have no sales or use tax). J.C. Penney and Montgomery Ward also collect tax on all mail order sales. Is it fair for Sears to compete with Spiegels, L.L. Bean and others who are not required to collect tax simply because they do not have a physical presence (or nexus) through a retail store or salesman? We think not. Is it reasonable to believe that Spiegels can administer and charge differential finance charge rates based on individual state law but cannot administer and collect different sales or use tax charges? We think not. Is it fair for small businesses in Michigan to compete with untaxed direct marketing prices? Of course not. We agree with David A. Broene of Broene's Furniture Ltd, Allendale, Michigan who wrote me February 28, 1987 to say:

"Thank you for your recent letter regarding sales tax problems with neighboring states. We have been very concerned about this problem due to North Carolina furniture outlets selling in Michigan. We have lost sales strictly because of the difference the sales tax makes. We can compete business-wise but the 4% tax does make a price difference. Hope you continue to pursue this matter."

We are here today to pursue this matter on behalf of thousands of small businesses like Broene's Furniture. We urge you to enact legislation to correct this gross inequity which impairs fair competition.

Thank you.

Mr. DORGAN. Next we will call on the comptroller of public accounts of Texas, Wade Anderson, executive counsel for the State Comptroller.

Wade, welcome.

STATEMENT OF WADE ANDERSON, EXECUTIVE COUNSEL, COMPTROLLER OF PUBLIC ACCOUNTS, STATE OF TEXAS

Mr. ANDERSON. Thank you very much. I appreciate the committee hearing our testimony on the taxation of mail order sales today.

I have a prepared statement which has already been given to the committee and I will not go over many of the issues which have already been addressed, such as the basic need for this type of legislation. That has been addressed and I second that testimony.

I would point out that 2 years ago, *National Bellas Hess* reached voting age. Twenty years ago, the Court in *National Bellas Hess* said this is a problem for the Congress to address. Now, the analogy to a person reaching voting age is not too far off when you start thinking about mail order sales.

In 1967—and I guess a little bit before that, when I was growing up—mail order sales were not a big issue. They were not a big issue to the States then, either. It is like a little child growing up. Now, mail order sales has gone through its teenage years and it has been a rambunctious growth.

The mail order sales business now represents a $100 billion a year business. Let me put that in perspective for you. If you took all the sales for the department stores and all the sales for the catalog show rooms and all the vending machine sales in this country and you added all those sales up, they still would not match mail order sales.

Now, over the past 10 years mail order sales have been growing between 6 and 12 percent a year. That is what we see them continuing to grow at. The average per capita consumption on mail order sales is approximately $246 per person per year in this country. Businesses purchase an average of $8,000 a year in mail order sales.

Now, there is probably a common perception that when a business buys something it ought to be tax free. That is just not the case. We have run estimates on what percentage of purchases by businesses of mail order sales are subject to taxes in Texas. They are approximately 88 percent taxable. They are not sold to somebody else, with the tax being collected from a third party.

In Texas, we have $7.3 billion estimated in mail order sales this year, and that has a revenue effect of approximately $159 million in tax that we will not be able to collect. Now, under your bill, Congressman Dorgan, we would be able to collect over $120 million of that with the $5 million cutoff. Under Congressman Brooks' bill, it would be closer to $108 million.

The increase that we have seen has been as a result of specialized catalogs, TV mail order, computer terminals. Interestingly enough, we have seen a decrease in general merchandise vendors like Sears.

Now, I suppose the reason for that is that you have got clear image-type publications, sellers that bring a wider range and a higher quality of products to your door now than happened 10 years ago or 15 years ago, but nevertheless that is what we see.

Television home shopping has been estimated by Paul Kagan Associates to grow 400 percent, that is 400 percent in 1987, with sales of $2.25 billion. They estimate that by 1991 those figures will be $7.2 billion. Right now, there are some 13 million homes involved. By 1991, 85 million homes.

Now, right before I came to Washington to testify, I saw an article I pulled out because I thought it was interesting, and this appeared—this was a little clip in Advertising Age, May 1987. It is about the Harris Catalog Library Mail Order Catalog Center Kiosk. I have never heard of such, but apparently it was first installed 2 years ago in the Fair Oaks Orangeville Library Branch in Sacramento. Essentially it is a library kiosk with 1,000 bound mail order catalogs, 1,000 catalogs. They represent 5 million products that you can buy.

How are local merchants supposed to compete with that? Where is the level playing field for that guy? I do not know, but this was touted as being a new and innovative way of putting a kiosk in your supermarkets, in your libraries, anywhere you have a market.

In Texas, we have had strong support for the legislation. But I would just simply end with the observation that this change in the congressional nexus requirements is needed and the time is long overdue.

Thank you very much.

[The statement of Mr. Anderson follows:]

Wade Anderson

Executive Counsel

Appearing for Bob Bullock

Comptroller of Public Accounts

State of Texas

TEXAS' VIEW ON NEED FOR MAIL ORDER SALES LEGISLATION

House Bill 1242 in allowing the states to require mail order sales companies to collect tax addresses one of the most serious problems facing the revenue departments and in-state retailers today.

In 1967, the U.S. Supreme Court said it was up to Congress to regulate and control mail order sales.

The time is past due for Congress to act.

When the case of National Bellas Hess v. Illinois Department of Revenue was decided, mail order sales were limited. Since then we have seen an explosive growth in this industry. A growth which has gone untaxed to the detriment of the tax revenues of the various states including Texas and has put local in-state vendors at a competitive disadvantage.

As sales tax rates increase in the states, the current advantage enjoyed by mail order sales companies will increase with a corresponding decrease in sales tax revenues and in-state retail sales.

While the growth in mail order sales has been aided by the tax advantage enjoyed by these companies, it has been influenced by many other factors in our society which did not exist in 1967.

Shopping patterns have been changed by the crowded malls, crime in the streets, the two wage earner family, and probably most importantly, the communications industry. When the Supreme Court issued its decision, 1-800 numbers were hardly used by the mail order industry. Now, they are regularly coupled with advertising seen on T.V. The idea of shopping through your T.V. was something "Time" might write about when discussing the future.

Well, the future is here. If you want to buy diamond earrings or goose down pillows, you no longer have to go to your local retailer. You watch T.V. and place your order.

The following statistics dramatically point out the importance of this segment of industry in our society. The mail order industry had an estimated $94 billion in mail order sales in 1985. Over one third of these sales were to businesses and about two thirds to individuals. Of those sales to businesses, many are for items used by the businesses to carry on their regular activities.

From the occasional magazine subscription or the model airplane of the sixties, Americans spent an average of $246 per capita a year on products in 1985 on items ranging from apparel, gifts, and magazines to bedroom sets. These products are brought to the consumers door and living room T.V. by some 12,000 mail order firms in consumer retail alone.

The savings made from not paying the sales tax more than make up for the shipping charges that buyers pay to receive their orders. A Texan can order a 500 dollar compact disk player, pay shipping charges from New York and still save $10.63 by not paying Texas sales taxes. Or he can send for a $3000 computer system from New Jersey, pay shipping charges and save $153.75 in Texas sales tax.

There are some giant mail order firms that dominate mail order sales. The top 250 U.S. mail firms account for over 43% of worldwide mail order sales.

In Texas alone, we have mail order sales of approximately $7.3 billion this year. Of these, $2.8 billion are to businesses and $4.5 billion are to individuals. We estimate each business spends an average of $8000 per year on mail order goods of which 88.2% are taxable in Texas. Over 94% of all goods purchased by individuals are taxable in Texas.

These sales translate into uncollected Texas tax of $159 million a year in 1987.

In arriving at these estimates we used three basic informational sources: Sroge, Mail Order Data 1985 and All About Mail Order 1983; Arnold Fishman, "Direct Marketing 1985," and Guide to Mail Order Sales 1985; and the Better Homes and Gardens panel survey.

Our Economic Analysis Center developed five separate approaches to determining the amount of mail order sales not currently taxed in Texas and used the data from these publications and the U.S. Bureau of the Census to arrive at the above estimate.

What do we see in growth? Over the next few years we expect mail order sales to grow at an annual percentage rate of from 6 to 12%. Consumer mail order sales as measured by census data on retail sales has grown from an average of 9% a year from 1972 to 1982. Mail order firms will clearly outstrip the growth in traditional retail sales by in-state vendors.

This growth will be caused by an increase in specialty catalogs, T.V. mail order sales, and sales of mail order goods over the phone and through computer terminals.

We see some decline in mail order sales by general merchandise vendors like Sears and Penneys. Wards abandonment of its mail order sales division may cause a short term dip in mail order sales.

Why are these changes taking place? The reasons include more working women and more two income families (which means more disposable income and more shopping by mail). The use of sophisticated computer marketing and 800 numbers is increasing. Also, there is a built-in edge for mail order companies, not only for the sales tax but for overhead, that makes them more competitive. The decline in rural population and the desire to examine the product before purchase are more than offset by these other factors. (In fact, in regard to examining the product, we see in the future telephones and home computers tied in with televisions to allow people to look at what they might buy.)

This growth could become explosive if some of the innovations mail order firms are currently experimenting with in television and computer sales spread nationwide over the next few years.

Television home shopping is projected to grow about 400% in 1987, according to an industry newsletter published by Paul Kagan Associates (PKA), Inc., and could increase from an expected $2.25 billion in 1987 to $7.2 billion in 1991. Americans in 13 million homes now have access to television cable network channels that continously sell products, spending an average of $45 a home a year on T.V. sales. PKA projects that these figures will jump to 85 million homes and $85 per home in 1991. Home shopping networks also intend to build their own catalogs and direct mail businesses atop their new-found customer lists to boost their take from the American home even further.

J. C. Penney Company, the nation's third largest retailer is currently testing its own television home shopping service, called Telaction. Customers would be able to use their phones as computer terminals to select the type of merchandise they wanted to view, women's clothes or garden tools, and then order the item over the phone.

The largest computerized electronic shopping service, Comp-U-Card International out of Stamford, Connecticut, had grown from 125,000 members in 1983 to more than eight million in 1986. Members pay $30 a year to order products by telephone or home computer.

Regardless of what happens with any particular TV or computer network, sales of products in America are no longer dependent upon a buyer walking into a retail store. American families will be increasingly "wired" into an electronic network that can provide them products as well as entertainment.

How can the sales tax continue to be a viable vehicle for revenues if it cannot deal with this phenomenon?

In Texas, we feel a federal bill is required to allow us to collect tax. Not only would it help with our fiscal problems, but more importantly it would put our local vendors on an even playing field. I receive complaints regularly from local vendors who call and say mail order competitors are beating them out of sales because of the sales tax. I have had complaints from such diverse vendors as gun dealers, dental supply companies and furniture retailers.

Texas also has a problem with mail order sales companies which may not be experienced by all other states. We apply the separate entity theory in taxing

companies in Texas. If a corporation is completely separate from a parent or related corporation, the corporation is treated as a separate entity unless an agency relationship can be established. This creates a loophole for any company that wants to set up a mail-order company outside the state.

This bill would cure this last problem.

How do businesses in Texas feel about national legislation like H.B. 1242?

Businesses in Texas have basically supported legislation, with few exceptions. We have received numerous letters from businesses and chambers of commerce supporting the concept of taxing mail order sales.

That is not to say we have not had objections. One of the letters we received cited a Peat, Marwick, Mitchell, and Company study saying the cost to change systems would be 2-3.75%.

It should be pointed out this is a one time cost which will go down after the system is in place. Any time a new tax is imposed or substantial modifications are made in an existing tax, vendors must make expensive modifications in their computer systems. This is no different.

Other companies have objected to auditing costs.

Auditing is simply a cost of doing business. Other vendors are audited, and I see no reason why mail order companies should be treated differently.

Another objection made is that a tax on mail order sales would inordinately hurt the elderly. I view this as a smokescreen. The fastest growing segment of consumers of mail order sales are the two-income families and the baby boomers.

In opposing taxation, the mail order companies have objected to the multiplicity of local jurisdictions. As a result, this bill provides a local tax can only be imposed on the mail order companies if it is collected by the state at a uniform rate in all geographic regions of the state. I would observe vendors doing business in several states collect local taxes. Computers make this possible. Objections which may have been valid ten years ago appear questionable now.

Again, let me say the time is long over due for correcting the inequities caused by the states' inability to require mail companies to collect tax on their sales. It is time to even out the playing field.

Mr. DORGAN. Thank you, Mr. Anderson.

Next we will hear from Freda Miklin, who is the tax compliance officer of Denver, CO, speaking on behalf of the National League of Cities.

Freda, welcome.

STATEMENT OF FREDA MIKLIN, DIRECTOR, TAX COMPLIANCE OFFICE, CITY OF DENVER, CO, ON BEHALF OF THE NATIONAL LEAGUE OF CITIES

Ms. MIKLIN. Thank you.

My name is Freda Miklin and I am the director of tax compliance for the city of Denver, CO. I am appearing today on behalf of the National League of Cities to urge prompt action on legislation authorizing the collection of State and local sales taxes on interstate mail order sales.

Much has been said quite eloquently today about the need for this legislation for States. I would like to say a few things about what the sales tax means to cities in this country.

As you have been told, there are some 6,700 local jurisdictions that had a sales tax in 1985. That is an increase of 36 percent from ten years ago. Revenues from sales taxes now make up nearly 16 percent of local revenues nationwide and for municipalities sales tax produced $8.5 billion in 1985, comprising some 18 percent of total tax revenues. Clearly, sales tax is second only to property tax as a revenue generator for cities.

In my own city of Denver, our 3.5 percent local sales tax produced $150 million in 1985, which is some 50 percent of our general fund revenues. For some cities, sales tax provide an even greater percentage of local revenue: In Huntsville, AL, 64 percent; Colorado Springs, CO, 76 percent; Baton Rouge, LA, 60 percent; Tulsa, OK, 78 percent.

In New York City, the 4.25 percent sales tax that was referred to by Mr. McGrath this morning produced $1.6 billion in 1984.

At stake for local governments in connection with the legislation that is now being considered by the subcommittee is between $250 and $500 million in revenue, with that amount expected to increase.

The bills now pending in the House do not address the concerns of local government and will result in continued discrimination against locally based businesses and large multistate retailers such as Sears who do collect the tax. Let me explain.

Both bills prohibit the collection of local sales tax unless local rates and coverage are uniform in all geographical areas of the State. In the vast majority of the States where cities have sales taxes, varying rates are employed. In the five States where municipal sales taxes are uniform, other levels of local government, such as counties or transit districts, impose a sales tax of a different rate or rates. Thus no single rate exists in any State which is uniform in all of the State's geographical areas.

It is our understanding that the primary obstacle to inclusion of local governments is the fear that such a provision would create undue administrative burden because of the number of local jurisdictions. While we understand that, we believe that the fears are

exaggerated. The arguments in support of providing broad protection for local sales tax collection efforts are compelling.

They include increasing equity for local retailers and multistate vendors, minimizing Federal interference with State and local relations, and protecting of an important local revenue source.

The enactment of *Bellas Hess* legislation, even without local government participation, will require the use of a computer based service to insure that the collection of State sales taxes is accurate because State sales tax rates and the definition of what is taxable and exempt vary from State to State.

Computer software packages already exist to facilitate retailer compliance with State and local sales tax laws. There is a company in Philadelphia by the name of Vertex that sells the necessary computer software on a subscription basis at a moderate price.

Both thresholds proposed in the two bills provide ample leeways for the absorption of administrative expenses. Collection costs can be further mitigated by the establishment of a national clearinghouse financed by the benefiting State and local jurisdictions. With such a system, a buyer or seller could call an 800 number to determine whether a particular item is subject to a State and/or local sales tax and the applicable rate. Remittance costs could be minimized by establishing a simplified system of information returns and revenue distribution using the States so there would not be any necessity for every catalog house to deal with every local jurisdiction. That is not our intention.

The seller would provide information organized on the basis of the ZIP Code relating to the transactions in the State on which sales tax was collected; the State would pass through the applicable tax receipts to the appropriate local jurisdiction on the basis of the ZIP Code information.

We strongly urge the subcommittee to broaden the pending legislation to insure that the interests of local government are addressed. We believe that the approach we have outlined today is workable, particularly when it is recognized that the additional costs for the collection of local sales taxes are minimal, while the benefits are great.

I would like to echo what Ms. Martin said and what Mr. Chu said: It is not our intention, our objective or our plan to audit all these local catalog houses, and I am certain that the cities would enter into whatever types of agreements are necessary to accomplish that objective, so that there would be a limitation as to how many audits these catalog sellers would have to face.

I would like to address one other thing that Governor Thompson said this morning, and that was the issue of sharing revenues. While we subscribe to the idea, the problem that exists with that is, as Mr. McGrath pointed out this morning, if a State like New York has a 4 percent State tax and a 4.25 city tax, if there is 8.25 percent collected on catalog sales that are delivered into New York City, I do not think there is a problem. If, however, there is only 4 percent, that is the State tax collected on catalog sales delivered into New York City, I would guess that there will be some problem in determining how that money would be shared with the city.

Thank you very much.

[The statement of Ms. Miklin follows:]

Statement of

Freda Miklin

Tax Compliance Office, Denver, Colorado

on

Interstate Sales Tax Collection

Good afternoon. I am Freda Miklin -- the Tax Compliance Officer for the City of Denver, Colorado -- and I am testifying before the Subcommittee on Select Revenue Measures on behalf of the National League of Cities (NLC). I am appearing today to urge prompt action on long-overdue legislation to authorize both state and local governments to collect sales taxes on interstate mail order sales and similar transactions.

BACKGROUND

Many of the cities and towns represented by NLC -- NLC represents 16,000 cities and towns through direct membership and membership in 49 affiliated state municipal leagues -- impose a sales tax on the purchase of personal property. According to the U.S. Advisory Commission on Intergovernmental Relations (ACIR), 6,668 local jurisdictions in 28 states imposed a sales tax of some sort in 1985, a 36 percent increase in the number of local jurisdictions with sales taxes since 1976. Even more significant, ACIR estimated that local governments collected revenues of about $21 billion in sales and similar taxes in 1985, a nearly 200 percent increase in revenues over the $7.2 billion collected in 1976 from taxes of this type.

Revenues from sales and related taxes now make up nearly 16 percent of local revenues nation-wide, up from 10.5 percent in 1976. For municipalities, the sales tax is, in comparison to other forms of local government such as counties, even more important as it produces $8.5 billion in revenues (compared to $23.4 billion in property tax revenues) or about 16 percent of $47.6 billion in total tax revenues for municipal governments. In those cities and towns which have a sales tax, of course, dependence is even greater.

In my own city of Denver, we impose a local sales tax of 3.5 percent which produced $150 million in 1985 or 50 percent of general fund revenues. For some cities, sales tax revenues make up an even greater percentage of local tax revenues: 64 percent in Huntsville, Alabama; 76 percent in Colorado Springs, Colorado; 60 percent in Baton Rouge, Louisiana; and 78 percent in Tulsa, Oklahoma. The local sales tax can also be a major source of revenue. A 4.25 percent sales tax in New York City, for example, produced $1.6 billion in revenues for 1984. In several states -- Alabama, Arizona, Colorado, Louisiana, New Mexico, Oklahoma, South Dakota, and Utah -- sales tax revenues make up more than 40 percent of local tax revenues. Clearly the sales tax has become more and more important to local governments as a source of revenue over the last decade.

Under most sales tax systems at the state and local level, both a "sales" and a "use" tax are assessed in order to limit the ability of buyers to avoid sales taxes. The sales tax applies to the actual purchase of the good. The use tax (which is identical in rate and coverage to the sales tax) applies to the "enjoyment" of a purchased good. Its purpose is to ensure that residents of the taxing jurisdiction do not escape the sales tax by purchasing goods in other jurisdictions and then having the goods delivered into the tax jurisdiction by the U.S. Postal Service or a private carrier. A person who pays a use tax generally receives a credit against any sales tax liability and vice-versa.

A gaping hole has been opened in this tax system by the Supreme Court, making it impossible to collect use taxes on a significant number of purchases from out-of-state sources. The Supreme Court has ruled on several occasions, perhaps most notably

in the 1967 National Bellas Hess v. Illinois Department of Revenue decision, that a firm which has no link to a state except mailing catalogues to state residents and filling their orders by mail cannot be subject to that state's sales tax.

The basis for this ruling was the lack of a sufficient "nexus" between the destination state -- the state in which the buyer lives -- and the origin state -- the seller's state. As a result, the imposition of a sales tax on such out-of-state transactions was deemed to violate Commerce Clause of the U.S. Constitution and to raise Due Process concerns. Justice Potter Stewart, writing for the six-person majority in Bellas Hess, said that if the destination state were allowed to impose a sales tax on such interstate transactions, then the "resulting impediments upon the free conduct of . . . interstate business would be neither imaginary nor remote."

Of particular concern to Justice Stewart was that variations among a firm's taxing jurisdictions in tax rates, exemptions, and administrative and recordkeeping requirements could entangle a business' "interstate business in a virtual welter of complicated obligations to local jurisdictions with no legitimate claim to impose 'a fair share of the cost of the local government.'" The Bellas Hess decision effectively exempts from state and local sales tax those goods sold by firms which are located out-of-state and do not have a place of business or other clear connection with the destination state.

Because of the Bellas Hess ruling, only Congress can authorize state and local governments to collect a sales tax on interstate mail order and similar sales by exercising its Commerce Clause powers to regulate interstate transactions.

At stake is $250 to $500 million in revenues for the nearly 7,000 local jurisdictions (including counties and transit districts) in 28 states which impose a sales tax on the purchase of goods. An even greater amount -- an amount estimated to be about $1.4 billion -- will be foregone this year by the 45 states (and the District of Columbia) which impose a sales tax. State and local sales tax bases are expected to erode further in the future as sales are increasingly made through the mail, cable television, broadcast television, and computer hook-ups.

In addition to the obvious importance of the sales tax to state and local government as a revenue source, two other policy considerations are relevant.

First, there are equity considerations. Mail order sellers now enjoy a competitive advantage over local vendors because of their de facto exemption from the sales tax which vendors with in-state operations are required to collect. Locally-oriented businesses -- many of which are small businesses -- are put at a major competitive disadvantage: The net cost of goods purchased from out-of-state sellers will inevitably be lower than goods purchased from local businesses because of the sales tax savings. They also enjoy a major advantage over the nation's larger multistate retailers (e.g., Sears and J.C. Penney) who, because they have outlets or similar operations in virtually every state, are subject to state and local sales taxes under the Bellas Hess ruling and must comply with the sales tax requirements of state and local governments around the nation.

Second, there are enforcement and compliance considerations. The loophole created by the Bellas Hess decision creates an incentive to avoid sales taxes through out-of-state purchases via the mails and other means. Federal legislation is essential to eliminate this incentive to circumvent local tax obligations and to prevent further growth in tax evasion.

PENDING LEGISLATION

For some 27 years, Congress has considered a number of proposals to establish rules for the imposition of a sales tax on goods which are delivered from a seller in one state to a buyer in another state. Once again this year, Congress is considering legislation to overturn or modify Bellas Hess and authorize the

collection of sales taxes on mail order sales and similar transactions. We believe the time is well past for legislative action on a matter which is of such vital importance to the nation's states and localities. However, the bills now pending in the House do not address the concerns of local governments and will result in continued discrimination against locally-based businesses and large multistate retailers.

Two bills have been introduced in the U.S. House of Representatives. One -- the Interstate Sales Tax Collection Act of 1987 (H.R. 1242), introduced by Rep. Byron Dorgan on February 25 -- has been jointly referred to the Ways and Means Committee and the Judiciary Committee. The other -- the Equity in Interstate Competition Act of 1987 (H.R. 1891), introduced by Rep. Jack Brooks of Texas on April 1 -- has been referred to the Judiciary Committee.

We will address the problems associated with both bills even though only one of them (H.R. 1242) has been referred to this committee. It is our hope that the Judiciary and Ways and Means Committees will move ahead in tandem on this legislation and will jointly seek a solution which ensures that the interests of local government are protected.

H.R. 1242: Section 2(c) of H.R. 1242 does not authorize a state to require the collection of local sales taxes unless "the combined rate of tax is imposed at the same rate on the same transactions in all geographic areas of the State." Further, section 2(d) requires that local sales taxes be collected and administered by the state in order to qualify for collection under the bill.

There are several problems with this provision.

First, in 17 of the 22 states (there are six additional states where counties and local transit districts have sales tax authority) where cities have the authority to impose a sales tax, varying rates are employed. Only in five states are municipal sales tax rates uniform -- California, Iowa, Minnesota, Texas, and Virginia -- and in those states other levels of government (e.g., counties and transit districts) are allowed to impose a sales tax of a different rate or rates. Thus, no single combined rate exists in any state which applies to the same transactions in all of the state's geographic areas.

Second, in states where home rule traditions are strong, local sales taxes are administered and collected at the local level. In these states -- which include Alabama, Alaska, Arizona, Colorado, Illinois, and Louisiana -- local sales taxes could not be collected under this legislation even if rates could somehow be made uniform because of the requirement for state administration and collection.

Also troubling for cities is the restrictive nature of the provision on information returns. Section 3 of the bill requires retailers to submit to the Internal Revenue Service information returns -- which then will be made available to state tax officials (but not local tax officials) -- which specify the gross receipts received from the sale of goods to residents of each state. This provision should be revised to ensure that local -- as well as state -- officials have access to data relating to the sale of goods by out-of-state sellers to residents of the local community.

H.R. 1891: Section 3 of H.R. 1891 would enable state governments to require out-of-state vendors to collect sales taxes, but local sales taxes would be covered by the legislation only if collected by the state and imposed at a uniform rate on all comparable transactions throughout the state. While some states have local tax systems which come close to this standard, no state has a system which meets the legislation's requirements. The legislation, like H.R. 1242, would effectively preclude participation by local governments.

RECOMMENDATIONS

It is our understanding that the primary obstacle to inclusion of local governments in the legislation is a fear that such a

provision -- because of the number of local jurisdictions involved -- would be perceived as creating administrative burdens for vendors. We believe that such concerns are greatly exaggerated and can be readily addressed by collection and remittance provisions which are sensitive to potential administrative problems.

Moreover, the arguments in support of providing broad protections for local sales tax collection efforts are compelling. These include: increasing equity for local retailers and multistate vendors; minimizing federal interference with state-local relations on tax matters; and protecting a growing local revenue source. In our view, the asserted administrative problems associated with local government coverage have been overblown and are a red herring.

An underlying objective of Bellas Hess legislation should be to minimize federal interference with state-local relations on sales tax matters. H.R. 1242 and H.R. 1891 are at odds with this objective because they require uniform local rates and coverage throughout the state. In other words, to obtain the benefits of the legislation -- greatly enhanced tax collection -- state and local laws governing local sales taxes would have to be completely rewritten in every state in the nation. In the process, home rule powers would be relinquished and extensive federal interference with state autonomy blessed.

We believe that several steps can be taken to minimize the additional collection and remittance costs which may be caused by coverage of local governments.

First, it must be recognized that enactment of Bellas Hess legislation, even without local government participation, will require the use of a computer-based or similar service to ensure the proper collection of state sales taxes. The addition of local governments therefore does not necessarily entail additional collection costs.

Under the state-based systems proposed in H.R. 1242 and H.R. 1891, it is likely that retailers will use computer software packages for compliance purposes because of the complexities of state sales tax systems. Not only do sales tax rates vary from state-to-state, but definitions of taxable and nontaxable items also vary. For example, Connecticut exempts items of clothing sold for less than $75 and all clothing for children of less than 10 years-old; Massachusetts, on the other hand, exempts items of clothing sold for less than $175. In other words, increased collection costs will have to be aborbed by retailers whether or not local governments are included. Since it is likely that sellers will have to invest in computer software or similar services, the additional cost for local coverage is likely to be minimal.

Cost-effective computer software packages already exist to facilitate retailer compliance with the sales tax laws of a multititude of jurisdictions. These computer software packages have been developed for the Sears and J.C. Penney's of the world. Such multistate retailers have long been subject to state and local taxes for out-of-state sales because they maintain places of businesses in numerous states and therefore have a sufficient nexus to be subject to use taxes in most destination states.

A Philadelphia-based company -- Vertex -- sells the necessary computer software in the form of computer tapes on a subscription basis. These tapes are updated monthly to reflect changes in state and local tax laws and are available at a reasonable price. The price for these tapes is $5900 for the first year and $3350 for each subsequent year. The same information may be obtained in looseleaf form on a subscription basis at a price of less than $500 a year. The utilization of such a computer software package is reported to be cost-effective for annual sales volume of $5 million or more.

In fact, both H.R. 1242 and H.R. 1891 appear to assume that sellers will have to absorb additional administrative expenses to collect state sales taxes. H.R. 1242 does not apply to vendors unless annual sales exceed $5 million; H.R. 1891 sets the

threshold for coverage at an even higher level -- $12.5 million. The inclusion of such a threshold may be appropriate to compensate for the new collection costs; however, it is our position that the threshold should be no lower than $5 million to ensure wider coverage.

Second, collection costs can be further mitigated by the establishment of a national clearinghouse -- to be established and financed by the state and local jurisdictions which benefit from the enhanced collection of sales taxes. Such a clearinghouse would provide up-to-date information for both sellers and buyers via a cost-free "800" telephone number. This central information source would ensure that buyers could obtain the necessary information to include payment for the sales tax in prepaid orders. For example, a buyer or seller could call an "800" number to determine whether a particular item of property is subject to a state and/or local sales tax in the destination community and the applicable tax rate.

Third, remittance costs could be minimized by establishing a simplified system of information returns and revenue distribution which is based on the zipcode system. Under such as approach, non-resident sellers would be required to file a single tax return on a quarterly basis (thereby minimizing filing frequency) per state -- it would cover the state and all affected local jurisdictions -- and remit tax receipts on the same basis. The return would state the gross sales tax receipts collected for the quarter from goods delivered to buyers in the state and its local jurisdictions; the seller would remit the receipts to the state in the form of a single check.

The seller would also be required to include pertinent information, organized on the basis of zipcode, pertaining to the underlying transactions such as the name and address of purchasers, the price of the goods purchased, and the sales tax collected. (This information, except for the sales tax information, is information which the vendor already maintains in order to deliver the merchandise to the buyer.)

The state would be required to pass through the applicable tax receipts to the appropriate local jurisdiction on the basis of the zipcode information. (Zipcodes conform to the boundaries of political subdivisions in 99.9 percent of the cases. The exceptions are rare and generally involve residential enclaves in unincorporated areas which were annexed by the adjacent municipality well after a zipcode had already been designated for the area.)

CONCLUSION

We strongly urge the Subcommittee to broaden the legislation to ensure that the interests of local government are addressed. We believe that the approach we have outlined today -- a national information clearinghouse and a simplified remittance system -- is workable, particularly when it is recognized that the additional costs for the collection of local sales taxes are minimal.

In our view, the considerations associated with increasing equity, minimizing federal interference with state-local relations on tax matters, and protecting local revenue sources clearly outweigh the supposed administrative burdens associated with the collection and remittance of local sales tax revenues.

Thank you.

Mr. DORGAN. Thank you very much, Freda.

Mr. Andrews had to leave to go to a Texas delegation meeting. He did want me to ask you to respond to Mr. Gregg's comments earlier today relating to the number of local taxing jurisdictions which could potentially send an auditor across the country. Congressman Andrews was interested in that and he asked me for purposes of the record to ask you to respond to that issue.

Mr. ANDERSON. All right. Thank you. I believe that it was indicated that there were over 6,000 local jurisdictions. About 1,000 of those are probably in Texas. We have almost 950, 960 local cities that have passed the local sales tax, plus we have some MTAs.

We have a saying in Texas, when you have a riot going on you send one ranger, one ranger, one riot. Our sales tax is a little bit the same way. We collect all the local tax for the various jurisdictions, and so I would say one company, one auditor. They are not going to be sending 1,000 auditors from Texas flying into some small hotel in New Hampshire. There would be one.

I understand that the vast majority of States are in exactly the same position. Approximately 30 States collect the tax for the local jurisdictions; many of the other States do not have local taxes. Now, there are some notable exceptions. Louisiana, with its parish system, is an exception. Colorado is somewhat of an exception, it is a little bit of a split system, as I understand. I suppose there are a few others.

But by and large that is a rabbit trail that you should not run down.

Mr. DORGAN. Thank you, Mr. Anderson.

Let me ask perhaps Mr. Chu or Ms. Martin the question about revenue loss figures. Some say that the revenue loss figures that are cited by ACIR are overblown. Others say in fact, if anything, they are understated. What is your impression of what these revenue figures mean?

Mr. CHU. First of all, the direct marketers in claiming that the $1 billion figure is overstated have admitted almost a $700 million revenue loss, and clearly with the growth of their business, that becomes a growing concern.

I see the number as understated because of the mere fact that ACIR looked only at the mail order sale issue, not at the cross-border sale issue that I mentioned in my testimony. In New York, we feel that the cross-border sales account for as much of a revenue loss as the mail order sales issue. If this is true for all States, then we are talking perhaps not of $1.5 billion but a $3 billion problem in all the States. I believe that those numbers, first of all by ACIR, were independently derived, they were not derived for any partisan purpose on the part of ACIR, as I believe some of the others can be accused of being.

Ms. MARTIN. I think the experience in the Great Lakes Compact, which was directed primarily at the cross-border sales and in fact with Ohio, we are doing border registration projects, meeting with vendors along the border, would lend substantive support to Mr. Chu's conclusion that those numbers are understated, that the number is much greater.

Mr. DORGAN. Thank you, Ms. Martin.

Let me ask a question about the number of local jurisdictions. I think if I were a mail order firm, I would argue that the number of local jurisdictions is substantial and growing. I know in my own State of North Dakota in recent years additional cities have adopted a sales tax. I would guess that more cities will adopt a local sales tax in the years ahead.

Is there some merit to the contention by a seller who is doing business in all the States that if they are threatened with not only having to comply with all the State laws but also all of the local jurisdictions, will those local jurisdictions not blossom from 6,700 to 8,700 to 12,700? If so, what does that mean to a mail order seller who is a modest size business interested in doing business, not evading taxes, and is willing to meet a reasonable amount of red-tape to comply with all the laws.

Ms. MIKLIN. Let me say this: I think it is unlikely that a local jurisdiction would enact a sales tax simply because they would now have the opportunity to tax direct market sellers, and I think that is unrealistic.

Mr. DORGAN. The point I was making is that my guess is more and more local jurisdictions are going to go to a consumption tax in any event, notwithstanding this issue.

Ms. MIKLIN. Absolutely. I think that is the trend and it is clear to see why. In our trickle down economy, there is not much trickling down by the time the city level is reached. I think that is going on all over this country, and I would expect also that that trend would continue and would increase.

I think that the cities are not unreasonable. The cities would have to, in order to participate reasonably in this plan, agree to a statewide base for tax collection purposes. I think that such a request would be reasonable and frankly that to ask any more would be unreasonable.

So in terms of what is taxable and what is not, I think that we could agree to a statewide base. In terms of rate, that is something that is easily handled by computers. You simply identify the ZIP Code of a particular jurisdiction and the rates that are applicable and assign a computer code to that jurisdiction at that rate, and when you receive an order from that jurisdiction, be it Keokuk, Iowa or San Francisco, Calif., you simply code it as such and then you can easily determine the rate. So I do not think that it needs to cause nearly the problem that has been spoken of.

More important, if it is not addressed, as more and more cities enact their own sales taxes it will become more and more of a problem, going back to the example of New York, where you have a city sales tax that is every bit as large as the State sales tax.

Mr. DORGAN. Well, let me just say that the concern you raised is an important one and I think the New York example is evidence of the unfairness that you allege would exist if we collected the State tax and not the local tax.

I think the direct sellers will legitimately be concerned about a proliferation of local consumption taxes that they would have to be dealing with. I am hopeful that we can reconcile those two interests, because I recognize what you said today as being important and, on behalf of the League of Cities, I think you make some good points on the local tax issue.

Ms. MIKLIN. Thank you.

Senator HEFNER. Mr. Dorgan, the Nebraska Legislature did not address the local sales tax problem, but during our public hearings and during our debate on the floor we did mention it and we came to the conclusion that what we would do if Congress sees fit to pass this bill, what we would do is come back with new legislation and probably take the average local sales tax, like I think in Nebraska right now the minimum is 1 percent and the maximum is 1.5 percent to local government, and so we would probably pick out an average figure, like the State sales tax is 4 percent and then we would probably have maybe 1 or 1.25 percent for the local government or something like that.

Mr. DORGAN. We will obviously do some evaluation of that issue and I want to thank all of you on this panel for giving us very important perspective for the committee record today. I think your testimony was excellent and I appreciate your willingness to come and appear before the subcommittee.

The chairman would next like to call the final panel. I would like to call Mr. Alan Glazer, chairman, Catalogue Council, president, Bedford Fair Industries, Ltd., Mount Kosco, NY., accompanied by Gary French, consultant, representing the Direct Marketing Association.

Next, the Parcel Shippers Association, Michael B. Fisher, president, secretary and general counsel, Fingerhut Corp. Minnetonka, Minn.; the Magazine Publishers Association, Robert Teufel, member of the board, president, Rodale Publishing Co.; National Taxpayers Union, David Keating, executive vice president; L.L. Bean, Inc., Freeport, Maine, William T. End, executive vice president; and Priority One Electronics, Chatsworth, Calif., Heath Kline, president.

If members of the panel will take seats, the Chair would like to point out that we would include your entire statements as a part of the permanent committee record and we would ask that in your testimony you summarize the statements before the subcommittee.

Let me say that the members of this panel represent the direct sellers. The committee is interested in hearing from you and making your comments a part of the record and we recognize that this is a controversial issue, and we want to hear from supporters and opponents of the legislation so that we might make judgments about what appropriate legislative activity might be for this subcommittee.

So let me first call on Mr. Alan Glazer, chairman of the Catalogue Council, accompanied by Gary French, consultant.

Alan, we would be pleased to hear from you.

STATEMENT OF ALAN GLAZER, PRESIDENT, BEDFORD FAIR INDUSTRIES, LTD., MOUNT KISCO, NY, ON BEHALF OF THE DIRECT MARKETING ASSOCIATION, ACCOMPANIED BY GARY FRENCH, CONSULTANT

Mr. GLAZER. Thank you. It is nice to be among friends today.

As it was indicated earlier, I am president of Bedford Fair Industries, and we are a direct marketing company headquartered in Mount Kisco, N.Y. where we employ more than 300 people. Bedford

Fair had sales of between $25 and $35 million. We are typical of thousands of companies that would be severely burdened by the tax collecting and record keeping responsibilities which H.R. 1242 and other similar bills would permit States to impose upon national direct marketers.

Beford Fair is a member of the Direct Marketing Association, a nationwide trade association representing all facets of the industry, including catalog companies, telemarketers, and direct response advertisers, as well as printers, list brokers, mailing houses, advertising agencies, and direct marketing suppliers that would also be severely impacted by this proposed legislation.

I currently serve as chairman of the DMA's Catalog Council, but my testimony here today is on behalf of the entire association and its more than 2,700 members. With me at the table on my left is Gary French, a partner in the well-known economic consulting firm of Robert R. Nathan & Associates. He is here to answer any questions you may have concerning the size of the number which tax administrators are talking about as relates to the sales tax revenue they expect to collect as a result of this legislation.

My testimony has been supplied to you in writing and I feel torn between reading or summarizing it to you and responding to many of the comments which I have heard today. I will not burden you by attempting to do both.

Chairman DORGAN. Mr. Glazer, please summarize. I have a copy of it here and I have looked it over previously and also feel free to comment on previous testimony.

Mr. GLAZER. Basically, I would like to concentrate on a couple of points, first indicating that the revenue estimates are in our opinion and based on economic studies grossly exaggerated, that it is far less than the $1.5 billion that has been repeatedly quoted here today.

Additionally, the industry, while it has grown rapidly, at the rate, indicated today as 12 percent, compares with the growth rate of the retail industry or traditional retailers of approximately 6 percent over the last decade.

In looking at growth rates, one however has to look at the base number. The mail order industry is far smaller, and even today, after enjoying approximately 12 or 10 percent growth in the past several years, still remains a very small part of the total retail sales.

The example given earlier was of a child reaching voting age. It is my assumption and conclusion, based on operating a mail order business, that we too have grown to manhood and therefore our rate of growth is likely to have leveled off as we have become a mature industry, satisfying a segment of the retailing desires of the public, and that it would not likely continue to grow at the rate that we have enjoyed in the 1970s and perhaps as late as the early 1980s.

I would like to provide you today with an example of the cost of compliance. It was indicated earlier today—we have indicated in our economic studies that it would cost 15 cents for every dollar collected to administer a tax collection plan, whereas it is estimated that the traditional retailer must spend about 1 percent or 1.5 percent of every dollar collected in administrative duties. That cer-

tainly would not represent a level playing field, to use a phrase that has been widely used today. It would put us at a great disadvantage, and there are quite formidable reasons for that.

In the case of a retailer, the customer steps up to the cash register and presents her $20 item, the cash register electronically computes the tax, and there is no way that the title to the goods is going to pass to the consumer until she has perhaps paid $21 for her $20 handbag, for example.

It is quite different in a mail order transaction, whereby a customer sends a check to the mail order company for $20 plus perhaps $3 for shipping and handling, or $23, and if she fails to pay the sales tax, at that point the mail order seller is involved in a Hobson's choice. Should he return the order to the consumer, whereby he would lose the sale? Would he irritate or aggravate the consumer who is expecting rapid shipment and immediate gratification of her desires by sending 2,000 or 3,000 miles away for this $20 blouse, handbag or what have you?

The cost of handling that order on an individual exception basis, as soon as it kicks out of the main stream, the cost to the mail order company immediately exceeds the amount of the sales tax, which if it was 5 percent on the $20 purchase, would be $1. It immediately costs more than $1 to handle that station.

If you assume that the average well-run mail order company has a pretax profit of approximately 5 percent, and if the sales tax due is 5 percent, as soon as this mail order company must pay that sales tax—and in the end that is what the company would do—they have lost the profit from the sale and they will have to go on to hope to make a profit on another sale.

Corresponding with the customer or returning the order literally are not real economic choices in this situation. The cost of advertising has been expended in the form of mailing the catalog, the merchandise has been purchased and is in stock, and if you hope to recover any part of the cost of goods or the advertising, you must accept the order even though the tax has not been paid.

Additionally, most States have on a State level, other than round tax amounts, 4.25 percent, 4.5 percent, 5 percent, et cetera. To ask a consumer to stop and do that math on a $32.88 purchase is likely to represent errors, whereby if $1.40 tax was due, she might pay $1.25. Is the mail order company supposed to chase the consumer for 15 cents, 25 cents or even 75 cents or even a dollar? The economics just prohibit that from being a real clearcut option.

Yet, the States have said regardless of whether you are able to collect the tax, you ought to pay the tax, and we in New York State do just that. We pay the tax based on 82 taxing districts, regardless of whether we successfully collect the tax or not. Therefore, doing business in New York State, where we are located, is less profitable, if profitable at all, than doing business in the other 49 States. However, I willingly accept that.

I have chosen to locate my business in New York State, I derive tangible benefits from the State, and I am therefore willing to pay that tax allocated over 82 districts, even though I am not entirely successful in collecting that tax.

However, to extend that burden to 45 other taxing districts would be more than a company such as ours, of our size, could

withstand. I would suggest to you, when I hear of diminimis rulings of $5 to $12 million, that perhaps it is not the size of the company which is at issue, but the size of the actual single transaction which in fact is at issue.

I have pointed out in my testimony, which apparently you have read, that even the States themselves, where they are not dealing face to face with the taxpayer, have decided that it is economically implausible to collect small amounts of taxes.

In North Dakota, the personal income tax form suggests that if the tax owed is less than $5, do not pay it; in Connecticut it is $10 for personal property taxes. In Florida, it is also $5. States routinely suggest that when taxes are due, that if the tax due is $1.42, please round that down to $1, as we ourselves, namely the States, do not want to be bothered collecting 42 cents on an individual transaction.

If the tax was easy to collect or plausible to collect, I doubt that we would be here today. We would collect the tax, just as we do where we have nexus. But in fact it is an impossible situation. It is easy for people sitting here without a financial responsibility to suggest that computers will simply handle this problem.

We have been attempting for 4 years to program our computer to respond to New York State's tax requirements for 82 different taxing districts. Despite the expenditure of many thousands of dollars, we are still calculating those taxes on a manual basis, being unable to comply with the complexities and in the case of our paying taxes to New York State, we pay it regardless of whether we collect it or not.

I might also point out that I think the problem will diminish in coming years. I do not see retailing as the way of doing business as disappearing, as has been suggested. Quite the contrary. As an indication that the catalog industry or the direct marketing industry has in fact matured, I can cite to you many companies who are now entering the retail business, opening stores in many States to take advantage of the advertising that they have created and the goodwill they have created by mailing their catalogs into those States.

As the companies, such as the Talbots, the Sharper Image, Williams-Sonoma and others, Brookstone, open stores in each of these States they have immediately and willingly begun to collect taxes on their catalog sales as well as on their retail sales, recognizing that the benefit of entering the retail markets, to capture retail sales at point of purchase makes it worthwhile for them to collect taxes on catalog sales as well, and by and large most of those companies are somewhat larger than $25 to $35 million.

I would welcome any other questions which might provide you with a contrasting point of view to the testimony provided previous to this panel today. Thank you.

[The statement of Mr. Glazer follows:]

Testimony of the Direct Marketing Association

before the

Select Revenue Subcommittee
of the
House Ways and Means Committee

delivered by

Alan Glazer, President
Bedford Fair Industries, Ltd.
and
Chairman, DMA Catalog Council

May 13, 1987

Good Morning. My name is Alan Glazer. I am President of Bedford Fair Industries, Ltd, a direct marketing company headquartered in Mt. Kisco, New York where we employ more than 300 people. Bedford Fair had sales of between $25 and $35 million last year. We are typical of the thousands of companies that would be severely burdened by the tax collecting and record keeping responsibilities which HR 1242 and other similar bills would permit states to impose upon national direct marketers.

Bedford Fair is a member of the Direct Marketing Association (DMA), a national trade association representing all facets of the industry, including catalog companies, telemarketers, and direct response advertisers, as well as printers, list brokers, mailing houses, advertising agencies, and direct marketing suppliers that would also be severely impacted by this legislation. I currently serve as chairman of DMA's Catalog Council, but my testimony here today is on behalf of the entire association and its more that 2,700 members.

With me at the table is Gary French, a partner in the well-known Washington economic consulting firm of Robert R. Nathan and Associates. He is here to answer any questions you may have concerning the size of the number which tax administrators are talking about: the amount of state tax revenue they expect to collect as a result of this legislation. Nathan & Associates performed a study for DMA on this issue. I will be referring also to a study performed for DMA by the Touche Ross Company which examined what it costs direct marketers to collect state use taxes. Copies of both studies have been made available to the subcommittee.

HR 1242 and other similar proposals which have been introduced in this Congress call for altering the traditional and constitutional relationship between the states and interstate commerce: granting states the authority to require out-of-state businesses to collect and pay state use taxes. We believe that these proposals are unconstitutional and unwise. We also believe that the inefficient tax collecting and unproductive costs called for by these proposals would be damaging to the national economy and short-sighted even from a state revenue perspective.

However, the major reason for my testimony and the primary reason for the widespread and determined opposition to this legislation is because of the impact on direct marketing companies and their customers. The costs for companies to collect these taxes would be heavy for some and ruinous for others, and the annoyance to mail order customers would, we feel, significantly reduce sales.

The reaction of tax administrators to this last statement is apt to be: "Aha, you admit it. Adding the tax would hurt your sales. That proves that you had an unfair tax advantage all along". Poppycock! The tax itself is not what would hurt sales. For over 90% of direct marketing the tax would <u>not</u> be the real problem. We are not thrilled with the prospects of the tax, you understand, but the tax itself of a couple of dollars on a dress for $44.88 is not going to hurt sales any more than it does in a retail store. I should note here that the average direct marketing sale is still around $50.00.

If the correct tax on mail order purchases could be magically and painlessly calculated and added in (as it is at the cash register in a retail store), then we would not be here today. The fact of the matter is that collecting taxes through the mail is not comparable to collecting taxes in person. Of necessity the procedures are more costly for the companies and more annoying and time consuming for the customers. A chart comparing the aggravation factor for mail order and the retail customers is appended to this testimony.

CUSTOMER AGGRAVATION

Without getting into specific problems such as what tax applies to gifts sent to another state or whether postage and handling is taxable in a given state, let me just say that a mail order customer, unlike her retail counterpart, must do work to determine the tax. She must determine what is taxable of the items she has order, what the correct rate is, and then actually do the computation. We catalogers spend an awful lot of money just getting the customer to the point where she feels she wants to buy something from our catalog. Then we do everything we can to make the ordering process simple and easy. The last thing we want to do at that point is to throw in a math problem involving decimals and taxes to really test our customer's motivation to buy. The tax rates under this legislation, it should be noted, would in all likelihood be different from the rate a customer is used to paying in the local stores.

Tax administrators say not to worry and, of course, that's easy for them to say. The millions of mail order customers would not be annoyed at them. They would be mad at the Congress and aggravated with the process of ordering through the mail.

COMPANY COMPLIANCE COSTS

Lost sales and aggravated customers are not even the worst problems that would be created by this legislation. Company compliance costs are what is most troubling to Bedford Fair and other mid-size direct marketing companies. To get some objective idea of the magnitude of the compliance burden, DMA commissioned the Touche Ross company to survey the industry. Actual on-site audits were conducted at thirty companies to verify each company's cost elements for tax collection where they are currently collecting the sales and use tax. A representative cross-section of large and small marketers was selected by Touche Ross. Some companies surveyed were collecting in all jurisdictions and others were collecting in only one or a few states.

Here is a summary of the findings of the study:

1. The average direct marketing company spends 15 cents in collection costs for every dollar of sales or use tax collected.

2. The average compensation from the states is just less than one percent, so that the average uncompensated cost of collection is 14 cents for every dollar of tax collected.

3. The single most significant variable affecting collection costs is size of the company. The larger the company, the smaller the cost of collection (generally) as a percentage of total sales or of taxes collected.

4. The results indicate that direct marketers, on average, have 6 or 7 times the collection costs of retailers that can collect sales tax at a cash register. (Comparisons are to the results of a 1982 study of retail collection costs conducted by Peat Marwick Mitchell Company.)

As the Touche Ross study documents, the average direct marketer now spends 15 cents for every dollar of use tax collected. Those collection costs come right out of profits, of course, and right off of taxable income for state and federal corporate income tax purposes.

Bedford Fair is currently required to collect taxes only on New York sales. Therefore, our New York business is less profitable than our business in the other 49 states. I accept this situation for three reasons:

1. I have freely chosen to locate my business in New York state, and

2. I derive tangible benefits from New York state services and accordingly have an obligation to support the state by payment of taxes and performance of certain duties, and

3. I have a voice in the political process of New York state.

If as a result of this proposed legislation, I were to be placed in the role of tax collector/use tax payer for the remaining 45 states, I believe that a substantial portion of the modest profit margin earned on net sales in each of those states would immediately evaporate. This an overwhelming economic burden, which would signal the demise of many small and moderately sized direct marketing companies.

Because of the importance of the compliance cost issue, it is surprising that no proponents of the legislation have made the slightest inquiry into the matter. Even the Advisory Commission on Inter-Governmental Relations (ACIR) recommended federal legislation in a 66 page "economic study" without any survey of the industry or

analysis of compliance problems. As a substitute for analysis, the ACIR study contains the following statement: "It should be noted that technological progress, data processing and electronic devices (cash registers, calculators, microcomputers, etc.) have probably reduced compliance costs in the last two decades". This blind faith in computers is uninformed. I can assure you that while computers make it possible to collect taxes on millions of small orders, they do not make it easy or inexpensive.

As a New York company, we are currently required to collect and remit sales taxes for approximately 82 different taxing jurisdictions within the state. Despite years of attempting to program computers to make these calculations for us, we have been unsuccessful in achieving this goal. The 45 additional taxing jurisdictions which this legislation would make us responsible for would pose even greater problems than the local subdivisions of New York. Not only are the tax rates different, but each state also has different lists of what items are exempt, different ways of defining those items, different lists of what buyers are tax exempt, different filing requirements, forms and procedures, a different set of auditors, and the power to enforce their assessments in courts of law hundreds and even thousands of miles from our company headquarters.

State taxing authorities themselves recognize the inefficiency of collecting small amounts of tax through the mail. The state of North Dakota, for example, instructs citizens on the state income tax form not to pay any tax if the amount owed is less than $5. Other states have similar provisions. Of course, if the taxpayer were standing in front of a cash register in the tax office, they would say in such cases: "That will be $4.37, please."

Customer errors are another large cost element for all direct marketers and particularly large for some. Retailers never have to worry about customers making mistakes in computing taxes. But we direct marketers cringe at the thought of having thousands of our customers doing math problems before determining how much money to send in on their orders. Some direct marketers currently experience nonpayment or underpayment by customers of approximately 9% of the total taxes due, and I am told that the percentage of nonpayment or underpayment increases when companies attempt to collect taxes outside of their home state.

Each error dramatically increases our cost of handling the order. Nonpayments present the marketer with a Hobson's choice: we can either return the order and ask for full payment, fill the order and bill the customer for the missing tax or simply pay the tax out of company profits (the state always wants full payment, regardless). Often times the last alternative is the least expensive and that puts the collection cost on those orders at 100%.

Computers notwithstanding, direct marketers have significant cost elements not present for fixed location retailers, and these are just on-going costs. No attempt has been made to estimate the one-time costs of creating the system to handle nationwide tax collecting. I would not even know where to begin to turn Bedford Fair into a tax collector and remitter for 45 other states. At a minimum this would involve acquiring computer software, in-house tax expertise and additional trained personnel. Many companies would be forced to expand or replace computer hardware. The burden of this transition would vary tremendously from company to company depending upon individual circumstances, but I can tell you that most direct marketing companies would be turned upside down. I don't know of any direct marketers who acquired computer hardware or software or set up systems for dealing with orders in anticipation of the possibility of collecting taxes in 46 different states.

The legislation before this committee highlights a problem: that it is very difficult to collect use taxes - difficult for the state and difficult for the marketers. When these taxes were first enacted decades ago, there was virtually no mail order industry. The sales tax was designed to work in a retail situation. There is simply no way to make this tax work either fairly or efficiently in the context of consumer mail order sales.

Tax administrators point to large national retail chains as proof that it is possible to collect taxes on mail order sales nationwide. I don't know if this is a serious argument, but the situation with regard to mid-size catalog companies such as Bedford Fair is in no way comparable to that of these multi-billion dollar retail giants. For catalogers with a retail presence in every state the cost of collecting each states use tax is greatly diminished by the fact that all of the analysis of each tax law and its effect on the company product line is already done as part of the retail store operation. In addition, many of the personnel necessary to deal with tax collecting and record keeping have already been hired or retained.

National retailers are also in a position to minimize or eliminate the costs of customer error and nonpayment of tax by offering revolving credit charge cards and the opportunity to pick up catalog orders at hundreds of retail locations. Finally, it should be noted that the national retailers can spread their sales and use tax collection costs over literally billions of dollars of total retail sales. This reduces the relative burden dramatically.

What about the example of some smaller direct marketers? Catalog companies such as The Talbots, The Sharper Image, Eddie Bauer, Banana Republic, Brookstone, and others are now collecting taxes in many states on their catalog sales because they have retail operations in those states. In each case the company made a calculated business decision that it was worth the increased burdens in order to take advantage of the retail potential which their catalogs had stimulated in those various states. The legislative proposal before this subcommittee would force hundreds and hundreds of the increased tax collecting costs of a sudden expansion into all 50 states at once without any of the benefits of an actual retail expansion.

One last point on compliance costs. Tax administrators have explained to direct marketers their lack of interest in compliance burdens by stating that "It's the cost of doing business." But is it? It is true that any burden that government places on businesses becomes a cost of doing business. However, under current law, purely out-of-state direct marketers have no obligation to collect taxes for states where they have no presence. So actually these burdens are <u>not</u> a cost of doing business for direct marketers. Tax administrators have come to Congress to try to make them a cost of our doing business.

FAIRNESS

State tax officials argue that we need to "level the playing field" by requiring all marketers to collect a sales tax or a use tax. I have already attempted to explain that this legislation would not create a level playing field since the problems associated with the collection of a use tax on mail order purchases are much more severe, both for the seller and the buyer. But fairness in tax policy also has to do with benefits. Sometimes higher tax burdens are justified by greater benefits. One might expect that state tax officials are justifying the imposition of greater burdens on mail order companies because they receive greater benefits from the taxing state. However, just the opposite is true. States provide considerable benefits in terms of police and fire protection, sanitation services, etc. for businesses located within their borders. Mail order companies with property or even one employee in a state currently collect that state's use tax in return for state services. However, this legislation would force mail order companies with no presence in a state to absorb the cost of collecting the state use tax in return for no services. In addition, without employees or property in a state a company is without a political voice to affect those tax laws or to appeal the often heavy-handed tactics of tax collectors.

CONSTITUTIONAL ISSUES

In fact, there are more fairness arguments against this legislative proposal than in support of it. The nexus standards which tax administrators would have Congress do away with were derived from the Commerce and Due Process Clauses of the U.S. Constitution. The concept of nexus is an attempt by the U.S. Supreme Court to determine the fairest possible way of determining who should and who should not be required to collect state use taxes. The Court determined that fundamental fairness demands that a company have some presence in a state and receive some benefits from that state in order to justify the collection duties imposed.

Doing away with the nexus concept in this context would also establish an extremely dangerous precedent. The recently enacted Florida advertising tax on national advertising demonstrates once again that states desperate for revenue are not shy about passing tax laws which are constitutionally unenforceable. It is arguable that the legislative proposal before you today, HR 1242, would give Florida the extra constitutional authority it needs to collect tax on national advertising with pernicious results. In any case, granting authority to the states to tax and otherwise burden interstate commerce without regard to nexus opens up a Pandora's Box of evils for the national economy.

HR 1242 presents still another constitutional problem a problem which is even more in evidence in the other House bill on this subject, HR 1891, introduced by Congressman Jack Brooks and drafted by the National Association of Tax Administrators. Both bills, in an effort to mitigate the enormous problems of collecting use taxes, have authorized an unprecedented federal intrusion into state tax policy. Even more limitations on the rights of states and their subdivisions to control their own tax policy would be necessary in order for the bill to be minimally feasible.

This federal intrusion may seem welcome in the short term. State sales and use tax laws are for the most part a hopeless maze of complexities developed over years of responding to various political pulls and pushes. As welcome as federally-mandated simplifications may seem, this is a dangerous road to start down. The long term implications of federal involvement in state tax policy is likely to cause more irritation than harmony, and this level of intrusion may itself be a violation of the Constitutional principle of Federalism.

REVENUE ESTIMATES

All else being equal, if HR 1242 were a reasonable proposal for collecting more taxes, then the size of the revenue estimate would not matter. And in this case, the main point to be made is that neither HR 1242 nor any of the other proposals are reasonable

-- they are drastic measures which would, in addition to, constitutional problems, create serious practical difficulties and revenue offsets as well.

In this context we feel it is useful to correct the revenue estimates used by proponents for the following reasons:

a) Revenue is the sole justification for the federal legislation (the "level the playing field" argument is not relevant to about 95% of the product categories sold by both retailers and direct marketers, and the legislation creates more unfairness than it cures);

b) The revenue estimates are not just a little off, they are twice the size of the actual potential revenue gain for the states; and

c) This is not a case of experts disagreeing concerning projections that depend upon assumptions. We are dealing with an existing tax, objectively determinable figures, and identical starting points. It is a simple case of the ACIR consultant doing a sloppy study and getting the wrong answer.

Therefore, in 1986, the Direct Marketing Association commissioned Robert R. Nathan and Associates (RRNA) to perform an economic study in order to check the accuracy of revenue estimates in a report issued in 1985 by the Advisory Commission on Intergovernmental Relations (ACIR). RRNA was instructed to begin the tax revenue calculations with the same industry sales figure as the ACIR used in their higher of two estimates. RRNA then worked with the compiler of these industry sales figures to make sure that all tax-neutral categories were removed before the tax calculations were made.

Here is a summary of the study's findings:

1. Only $694 million in additional state and local tax revenues could have been generated had the proposed legislation been in effect in 1984, which is less that half of the ACIR estimate.

2. Fifty percent of taxable mail order sales by companies with $12.5 MM in mail order sales (the threshold in the ACIR recommendation) are already subject to a collection duty.

3. When compared to existing state and local revenues, the additional revenue potential of the proposed legislation averages only 0.13 percent of current receipts.

4. The revenue figures are based on the assumption that every penny of uncollected tax could be collected at no cost to the state governments and with no adverse affect on other sources of revenue. In actual fact, states would realize only a fraction of the revenue identified.

5. According to documented trends in the direct marketing industry it appears that the amount of uncollected tax on mail order purchases is likely to decline in coming years without any change in the law. Companies involved in direct marketing are voluntarily acquiring nexus in many states because of marketing advantages, for example: opening retail stores (dozens of well known catalogers have already opened stores in multiple states), establishing 800 number calling centers and setting up regional distribution centers for faster delivery.

SHRINKING PROBLEM

HR 1242 would mean an unprecedented expansion of state taxing power, a violation of traditional constitutional values, unproductive costs for American businesses, and damage to the U.S. economy in the pursuit of a negligible amount of state tax revenue. But perhaps the greatest problem with this legislation is that it is unnecessary. It is a drastic and expensive solution to a problem which is getting smaller by itself.

Tax officials have taken a quick and superficial look at direct marketing and concluded that mail order buying is a rapidly growing hole in state sales tax coffers. Based on this conclusion, state tax administrators have in the past two years devoted an extraordinary amount of energy to this issue, inciting local retailers against out-of-state companies and advocating Congressional action to grant states power over interstate commerce. However, the need for federal legislation in this area should not be based on such a superficial analysis of direct marketing. Yes, the industry is still growing (although not as rapidly as in the previous decade). But take a closer look at the new growth areas of direct marketing: political fundraising, charitable fundraising, insurance sales, and the sale of investments and financial services. What, pray tell, do any of these have to do with sales tax? Nothing. Yet the figure used by tax administrators in

newspaper articles and speeches to represent the size of direct marketing and its threat to sales tax revenue is invariably 3 times too large because it contains the $80 + billion a year in direct marketing "sales" attributable to fundraising and other tax-exempt categories.

Mail order marketing of taxable consumer products is still growing at a healthy, if more modest, pace; but here too the major trends should be a great relief to tax administrators everywhere. The fastest growing catalog operations are moving rapidly into retailing, setting up stores to profit from the demand which their catalogs create among the 40-50% of the American consuming public that wants to see a product, feel it, try it on, and take it home immediately. As more and more companies such as The Talbots, The Sharper Image, Banana Republic and Williams-Sonoma open stores in more and more states, they are required to collect state taxes on their catalog sales in these states. Likewise, more and more companies are expanding into more states to improve their direct marketing with 800 number calling centers, regional distribution centers, the use of new technologies, etc.

If these trends continue (as industry experts expect) more and more companies will be collecting more tax in more states. Under these circumstances drastic legislative measures would not seem to be called for. It is a good time to remember the words of the ancient Chinese proverb: "Never swat a fly on your neighbor's forehead with a hatchet."

The Customer Aggravation Factor:

Comparison of Sales Tax and Use Tax

	Sales Tax	Use Tax
Visibility	Almost invisible -- the least noticed form of taxation	Painfully visible -- mail order customers not only have to confront the tax, they have to do all the calculations themselves.
Is the item taxable?	Cashier figures it	Customers must know what is taxable or look it up or guess.
Tax Rate	Programmed	Customers must know what the rate is or look it up or guess.
Total Tax	Cashier figures it	Customers must multiply the correct tax rate times the sale price of all taxable items and add the tax to the price total.
Postage and/or handling -- taxable?	Not applicable	Depends upon state law. (there are four different possibilities)
Gifts -- what tax?	No change	Items shipped to other states are taxed according to the laws of the other state which the customer would have to know or look up or take a guess.

Mr. DORGAN. Thank you. Mr. Glazer, I do have a couple of questions, but I would like to wait until the entire panel has spoken.

Mr. GLAZER. Thank you.

Mr. DORGAN. I would next like to call on Michael Fisher, from the Parcel Shippers Association. Mr. Fisher is president of that association.

Mr. Fisher.

STATEMENT OF MICHAEL B. FISHER, VICE PRESIDENT, GENERAL COUNSEL, AND SECRETARY, FINGERHUT CORP., MINNETONKA, MN, AND PRESIDENT, PARCEL SHIPPERS ASSOCIATION

Mr. FISHER. Thank you very much, Mr. Chairman. Good afternoon.

My name is Michael B. Fisher, and I am vice president and general counsel and secretary of Fingerhut Corp., a Minnesota mail order company, and president of the Parcel Shippers Association, a group of approximately 400 businesses who utilize the U.S. Postal Service and other carriers to ship parcels in interstate commerce. Because shipment is almost always from our seller/member in one State to customers in another State, H.R. 1242, if it were to become law, would have a negative impact upon our members.

First, there is a public misperception that there is an inequity or an unlevel playing field in the current situation which we have heard much about this morning. As a practical matter, most mail order sellers, including the overwhelming majority of our members, charge a shipping and handling charge to cover the cost of shipment by mail.

Further, in the broad predominance, a mail order business' unique product is one reason people shop by mail. Thus, the same goods in general are not available at retail stores. While the shipping and handling charges can vary from case to case, it is a charge the local retailer does not assess. It does seem to me that while an out-of-State mail order buyer may not be paying sales tax, he has paid a compensating charge because he is buying by mail. This seems to erode the so-called advantage.

I understand that there are isolated cases, but in the predominant situations it is just not the case. Further, the argument is often made that the two giants of retailing, which are also the two largest mail order companies, collect sales tax in every State, so everybody can do this.

While much can be said of the specious comparison, a couple of points should be made. First of all, these companies are present in every State. Besides the services they receive from the States, their local presence enhances their sales opportunities, much as Mr. Glazer has explained.

They have regional distribution centers, they are more local, many of the so-called mail order sales are actually consummated at an order counter. The point is the computation of sales tax in these cases is no more difficult than it is for an in-store retailer. In the mail order situation that is different. Most of the members of the Parcel Shippers Association have single locales for which they would have to compute the plethora of State sales tax rates, each based on different rules.

Even assuming there were only 46 jurisdictions and not the thousands per the testimony we heard by the prior panel, the rules are confusing and inconsistent with one another. In some States clothes are taxed, in some States clothes are not taxed. In some States some food is taxed, in some States no food is taxed. In some States, this is a fact, clothing under a certain value is not taxed, while clothing over that value is taxed. In another State, children's shoes, defined by the size of the shoe being sold, is taxed, while in other States there is no tax on children's shoes. It makes it very confusing for our customers to decide what is taxable.

And while I sincerely laud creative suggestions such as an 800 number to help the customer, the plain commercial reality is the moment of sale is lost if the customer has to resort to an 800 number to make——

Mr. DORGAN. Mr. Fisher, at one point in North Dakota eggs were taxed and chickens were not.

Mr. FISHER. Which should you buy first? [Laughter.]

I appreciate that you understand the confusion of the rules, Mr. Chairman.

In spite of the computerization, it costs our members a great deal more than the two giants of retailing to play on the level playing field.

We heard about store transactions being straight-forward, I cannot get the goods without paying the tax. In point of fact, our company does collect sales tax in a number of jurisdictions where we have nexus, and in tens of thousands of situations each year, customers stiff us, refuse to pay the sales tax portion of the amount due, and while we do pursue them, because we try our best to collect what is due us, it is often not feasible to instigate persistent, effective efforts for $1.80, $2, $7, yet we still must remit these amounts to the States and they do come right off our bottom line.

In fact, the *National Bellas Hess* case, besides mentioning the commerce clause consideration, does discuss at some length the due process considerations and, frankly, we just do not know what the Court would have done with those due process considerations had H.R. 1242 been the law. There is certainly a strong tone in that case that indicates that considerations of due process do affect the nexus question. And if a tax is really due from the customers, as is the case in a use tax situation, the State ought to deal with the customers instead of businesses—the fairness issue—which are thousands of miles away and have no relationship to the State.

In fact, the *Bellas Hess* case and related cases actually operate to correctly cause many companies to collect sales tax. As I say, our company collects tax in a number of jurisdictions where we have a nexus.

I heard the gentleman from Texas testify before about kiosks. It certainly is an arguable proposition that the physical presence of a kiosk may or may not be nexus, the point being that we do not need H.R. 1242 to cause such people to pay a tax if it is otherwise due. This is not a loophole. There were reasons in the *Bellas Hess* case that people who have no relationship to a State should not be made to collect for it.

Much has been said of the costs of direct marketers collecting tax. We find this to be true as well, and I shall not say more about it at this time.

So, in summary, the bill will not level the playing field. There is most often not a price advantage to shopping by mail. The fact that the giants of the retailing industry can afford the costly procedures necessary is in no way indicative of the burdensome costs to other companies. The bill tampers with notions of due process. A line of cases since *Bellas Hess* have shown that a company with appropriate nexus can be made to collect a use tax.

Also, to address one of Mr. Chu's concerns, there are formulations for a sales tax law which can address border sales issues without involving the direct marketing companies which should be protected by the due process considerations.

The benefits of the legislation are overstated and the burdens are understated.

I thank you very much for listening to our testimony.

[The statement of Mr. Fisher follows:]

STATEMENT OF MICHAEL B. FISHER
PRESIDENT OF
PARCEL SHIPPERS ASSOCIATION
ON H.R. 1242

Mr. Chairman, members of the Committee, good morning. My name is Michael B. Fisher, I am President of the Parcel Shippers Association, a group of approximately 200 businesses who utilize the U.S. Postal Service and other carriers to ship parcels in interstate commerce. Because shipment almost always is from our seller/member in one state to a customer in another state, H.R. 1242, if it were to become law would have a negative impact upon our members.

First, there is a public misperception that there is an inequity in the current situation which gives out-of-state sellers an advantage over in-state retailers because out-of-state commercial sellers do not have to collect sales tax. As a practical, commercial matter, most mail order sellers, including the overwhelming majority of our members, charge a shipping and handling charge to cover the costs of shipment by mail. While this charge varies from case to case, it is a charge which the local retailer does not assess to a customer walking into the store. Thus, in the overwhelming majority of situations, while an out-of-state mail order buyer may not be paying sales tax, he is paying a compensating charge because he is buying by mail which certainly causes that customer not to perceive any "advantage" by saving sales tax dollars.

Further, the argument has often been made that the two largest mail order companies collect sales tax in every state so everybody can do this. While much can be said of this specious comparison, at least a few points must be understood clearly. The two largest mail order companies operate in every state, and benfit from being present in the state. Besides various state services, the local presence enhances sales opportunities. They have regional distribution centers and many of the so-called "mail order" sales are actually consummated at an order counter. The point being that the computation of sales tax in such cases is no more difficult than it is for an in-store retailer.

Most of the members of the Parcel Shippers Association on the other hand, have single locales from which they would have to compute the plethora of state sales tax rates, each based on different rules. While there are, approximately, more than 7,000 sales taxing jurisdictions in the United States and varying rules - clothes are taxed or clothes are not taxed, food is taxed or food is not taxed, clothing under a certain value is not taxed, children's shoes are taxed or children's shoes are not taxed, food sold with non-food items is taxed on the value of the whole or food sold with non-food items is taxed only on the food components, etc. - merely being in the age of computerization does not give our members which are businesses vastly smaller than the two giants of retailing the wherewithal to deal on the so-called "level playing field."

Furthermore, when a sales tax is assessed in a store transaction or with a clerk, if the sales tax is not forthcoming the transaction is not consummated. In a mail order situation at my company, for example, tens of thousands of times each year customers "stiff us" for the sales tax portion of the bill and while we pursue the amount due to the same extent we would pursue a like amount due if unpaid on the product, it often is unfeasible to instigate persistent, effective collection efforts

for $1.80 or $2.34 or $7.69. Yet, we still must remit these amounts to the state. The fact that a tax is due but not paid is already a costly element to those of our members who do collect sales tax where required to under the tests set forth in National Bellas Hess and related cases.

In fact, the National Bellas Hess case, besides mentioning Commerce Clause considerations, discusses at some length the due process considerations of a state hundreds or even thousands of miles away being able to mandate a company which has no contact with the state and derives no special benefits therefrom to become its collection agent. If a tax is really due from the customers, as is the case in a use tax situation - the state ought to deal with its customers and not interfere with a business which has no relationship whatsoever with it.

In fact, the tests set forth in Bellas Hess and related cases actually operate to correctly cause many companies to collect sales tax. My own company, Fingerhut Corporation, for example, now collects sales tax in a number of states because the requisite nexus is present, we do not collect in others where there is no such nexus. To us the system does work. While we sympathize with the great need for revenue which all governments are experiencing, H.R. 1242 is not the appropriate solution to the problem. This is not a loophole.

The members of our association endorse the remarks and findings of the Direct Marketing Association testified to here today to the effect that collection of sales taxes three to fifteen times as expensive for mail order companies as it is for store retailers. Further, revenue estimate by proponents are vastly overstated.

In summary, this bill will not level any playing fields as there is most often not a price advantage to shopping by mail and the fact that the giants of the retailing industry can afford the burdensome costs to other companies. The bill tampers with notions of due process. A line of cases since National Bellas Hess has shown that a company with appropriate Nexus can be made to collect use tax. Finally, the benefits of such legislation are greatly over-estimated while the burden so high cost in collecting such a tax are understated.

For these reasons we respectfully testify that H.R. 1242 or any bill with a like purpose should not become law. Thank you.

Mr. DORGAN. Thank you, Mr. Fisher.

Mr. Teufel, thank you very much for being here. We would like to call on you. You are a member of the board of Magazine Publishers Association, and we would be glad to hear your statement. Again, if you would summarize, we would appreciate it and we will include your entire statement as a part of the permanent committee record.

STATEMENT OF ROBERT J. TEUFEL, PRESIDENT, RODALE PRESS, INC., EMMAUS, PA, AND MEMBER OF THE BOARD OF DIRECTORS, MAGAZINE PUBLISHERS ASSOCIATION

Mr. TEUFEL. Thank you, Mr. Chairman.

I am Bob Teufel, president of Rodale Press. I appear today as a member of the board of directors of the Magazine Publishers Association.

The Magazine Publishers Association is a national organization representing 217 publishing houses that publish more than 800 consumer interest magazines in the United States. MPA membership includes weekly news magazines and a wide variety of publications covering the interests of the American people—art, literature, science, sports, politics, crafts, hobbies, homemaking, and many others. Ninety percent of all subscriptions sold in the United States are sold by mail order solicitation and response; they account for about 200 million subscriptions annually.

Mail order subscriptions are particularly prevalent outside of major metropolitan areas where newsstands are few in number and carry a very limited number of publications. In fact, where we do most of our mailings there is no playing field. Small circulation magazines—journals of opinion, specialized magazines such as Successful Farming or Foreign Affairs, as well as our own Runners World Magazine, as well as magazines that carry little advertising rely on subscription revenues to stay in business. So any legislation or administrative action that threatens to impose a greater cost burden on the publisher is of utmost concern to the magazine publishing industry.

H.R. 1242, the subject of this hearing today, would permit the several States to require a retailer, as defined in the bill, to collect sales or use taxes in certain circumstances, also described in the bill. To us, this means that, for instance, the District of Columbia could require any publisher located outside the District to collect the D.C. sales or use tax on a mail order subscription sale, even though the publisher has no physical presence or tangible business activity here. He simply uses the U.S. Postal Service to solicit and receive mail order subscriptions from District residents, as elsewhere. We oppose the legislation.

If enacted, H.R. 1242 would permit the 50 States to impose their 4 or 5 or 6 percent sales taxes upon the media-magazines and newspapers sold in interstate commerce. In turn, the publisher would attempt to pass the burden of that tax on to advertisers or subscribers, or both.

Of course, you have heard in previous testimony how difficult that is. Collecting the tax and paying multiple jurisdictions would

be an extra cost and that burden, too, will have to be passed on—either that or the publisher takes it off the bottom line.

In cases where advertising revenue is limited, subscription prices would have to be increased to pay the added cost, and circulation will be adversely affected. There is an inevitable loss of readership. Most of the members of our association have run very careful tests on that. There is an inevitable loss of readership. Studies consistently show that when prices go up, sales decline in almost direct proportion. All this, because State governments search out tax resources beyond their geographic borders.

The authority of State governments to tax foreign businesses has a long history. The present state of the law is that in order for a State to tax a foreign business, the business must maintain some tangible presence in the State—a retail store, a warehouse, a salesman, an office—and we, and again members of MPA, do pay the sales tax in areas where we do have nexus.

In 1967, the Supreme Court considered whether "nexus" and therefore tax liability existed when the only contact between the seller and the State was the seller's use of the postal system. That case, *National Bellas Hess* v. *Illinois*, dealt with Illinois' statutory requirement that a mail order—I am not going to go through this, of course, since everyone here I am sure is quite aware of the consequences of the *National Bellas Hess* case and how relevant it is to all this here.

We do recognize and appreciate that today many States are hard-pressed for revenues, and we appreciate that difficulty. We do not think the answer is for Congress to bail them out by permitting taxation of businesses who have no connection with a State except through the Postal Service.

The interstate commerce clause is in the Constitution for a good reason. It is an essential ingredient in the Constitution that makes America a Nation, rather than a confederation. The balance of Federal-State powers achieved over two centuries built the Nation. Surrendering to the States the power to tax interstate commerce, to tax where the State has given nothing, goes against that national principle. Yet, that is what H.R. 1242 does, it tells the States that they may tax a transaction on the basis of nexus fabricated out of thin air and a post office box or a ZIP Code.

Twenty-two years ago, the Committee on the Judiciary of this House of Representatives examined in depth State sales and use taxes and found the subject "exceedingly troublesome." The committee said, "the task of making the sales tax effective and workable inevitably falls upon the Congress." We agree. But H.R. 1242, while perhaps "effective and workable," is also complex, costly, and, most of all, inherently unfair. We are opposed and we hope the subcommittee will not take favorable action on this legislation.

Thank you.

[The statement of Mr. Teufel follows:]

STATEMENT OF ROBERT J. TEUFEL, IN BEHALF OF THE MAGAZINE PUBLISHERS ASSOCIATION

Mr. Chairman, I'm Bob Teufel, president of Rodale Press, Inc. I appear today as a member of the Board of Directors of the Magazine Publishers Association.

The Magazine Publishers Association is a national organization representing 217 publishing houses that publish more than 800 consumer interest magazines in the United States. MPA membership includes weekly news magazines and a wide variety of publications covering the interests of the American people—art, literature, science, sports, politics, crafts, hobbies, homemaking, and many others. Ninety percent of all subscriptions sold in the United States are sold by mail order solicitation and response; they account for about 150 million subscriptions annually.

Mail order subscriptions are particularly prevalent outside of major metropolitan areas where newsstands are few in number and carry a very limited number of publications. Small circulation magazines—journals of opinion, specialized publications like Successful Farming or Foreign Affairs, as well as magazines that carry little advertising rely on subscription revenues to stay in business. So any legislation or administrative action that threatens to impose a greater cost burden on the publisher is of utmost concern to the magazine publishing industry.

H.R. 1242, the subject of this hearing today, would permit the several States to require a retailer, as defined in the bill, to collect sales or use taxes in certain circumstances, also described in the bill. To us, this means that, for instance, the District of Columbia could require any publisher located outside the District to collect the D.C. sales or use tax on a mail order subscription sale, even though the publisher has no physical presence or tangible business activity here. He simply uses the United States Postal Service to solicit and receive mail order subscriptions from District residents, as elsewhere. We oppose the legislation.

If enacted, H.R. 1242 would permit the 50 States to impose their 4 or 5 or 6 percent sales taxes upon the media—magazines and newspapers sold in interstate commerce. In turn, the publisher would attempt to pass the burden of that tax on to advertisers or subscribers, or both. Collecting the tax and paying multiple jurisdictions would be an extra cost and that burden, too, will have to be passed on—either that or the publisher takes it off the bottom line. In cases where advertising revenue is limited, subscription prices would have to be increased to pay the added cost, and circulation will be adversely affected. There is an inevitable loss of readership. Studies consistently show that when prices go up, sales decline in almost direct proportion. All this, because State governments search out tax resources beyond their geographic borders.

The authority of State governments to tax foreign businesses has a long history. The present state of the law is that in order for a State to tax a foreign business, the business must maintain some tangible presence in the state—a retail store, a warehouse, a salesman, an office—something that fulfills the concept in law known as "nexus." In 1967, the Supreme Court considered whether "nexus", and therefore tax liability, existed when the only contact between the seller and the State was the seller's use of the postal system. That case, *National Bellas Hess v. Illinois*, dealt with Illinois' statutory requirement that a mail order house collect the Illinois sales tax, and whether that requirement violated the Due Process Clause of the Fourteenth Amendment and the Commerce Clause of Article I of the Constitution. The Court said it did. The Commerce Clause, the Court concluded, required "some definite link, some minimum connection, between a state and the person, property or transaction it seeks to tax." Such a connection was not present, the Court said, where the only "link" was the use of the United States mails. "Indeed," the Court said,

"It is difficult to conceive commercial transactions more exclusively interstate in character than the mail order transactions here involved. And if the power of Illinois to impose use tax burdens upon *National* were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote." 386 U.S. 759.

We believe the distinction set forth in *National Bellas Hess* is good public policy. It requires an affirmative answer to the key question, "Has the State given anything for which it can ask return?" *Wisconsin v. J.C. Penney Co.*, 311 U.S. 435 (1941). Where the only presence of a business enterprise in a State is in a customer's mail box, the answer is "no." There is no police protection, no public service, no benefit whatsoever to the seller, because the seller is not there. States cannot take credit for the United States mails. To change the law, to overrule *National Bellas Hess*, really does mean "Taxation Without Representation." That may sound melodramatic, but our Forefathers who rebelled against the Townsend Acts received far more protection from George III than any publisher receives from a State that is on the other end of a Zip Code.

We recognize and appreciate that today many States are hardpressed for revenues. Florida, with a burgeoning population and great demand for public services, recently extended its sales tax to services and interstate commerce, including air

transportation and radio, TV, and magazine advertising. Texas, in the economic doldrums because of low oil prices, has been searching for new revenues. We appreciate their difficulties, but we don't think the answer is for Congress to bail them out by permitting taxation of businesses who have no connection with a State except through the Post Office.

The Interstate Commerce Clause is in the Constitution for good reason. It is an essential ingredient in the Constitution that makes America a Nation rather than a confederation. The balance of Federal-State powers achieved over two centuries built the Nation. Surrendering to the States the power to tax interstate commerce, to tax where the State has given nothing, goes against that National principle. Yet that is what H.R. 1242 does: it tells the States that they may tax a transaction on the basis of "nexus" fabricated out of thin air and a post office box.

Twenty-two years ago, the Committee on the Judiciary of this House of Representatives, examined in depth state sales and use taxes and found the subject "exceedingly troublesome." The Committee said "the task of making the sales tax effective and workable inevitably falls upon the Congress." [House Report 565, 89th Congress, 895 (1965)] We agree. But H.R. 1242, while perhaps "effective and workable," is also complex, costly, and most of all, inherently unfair. We are opposed, and we hope the Subcommittee will not take favorable action on this legislation.

Mr. DORGAN. Thank you, Mr. Teufel.

We would like next to hear from Mr. David Keating, representing the National Taxpayers Union.

Mr. Keating, we would appreciate your summarizing your testimony and we will make your entire testimony a part of the record.

STATEMENT OF DAVID L. KEATING, EXECUTIVE VICE PRESIDENT, NATIONAL TAXPAYERS UNION

Mr. KEATING. Thank you, Mr. Chairman.

I appear on behalf of our 150,000 taxpaying members this afternoon. We oppose H.R. 1242 because we think it is bad Federal tax policy. It will raise taxes on the American public, will reduce consumer choice, and will add new administrative burdens on an IRS barely competent to answer taxpayer questions.

This bill proposes an odd tax increase because if Congress approves it, they get the blame but the States get the revenue. This talk from the States about a revenue loss is a bit disingenuous. I have yet to hear one State representative indicate that they will turn back the increased use tax collections back to sales taxpayers in the States in the form of a lower sales tax rate or lower income tax rates or lower property tax rates. They plan to keep and spend the money, especially Governor Thompson of Illinois, from what I can tell.

Many States now have unenforceable and uncollectible use taxes on their books. We think the appropriate response should be for the States to tailor these taxes after the Supreme Court's interpretation of the U.S. Constitution.

A fundamental question in this whole debate is who owes the tax. Is it the consumer or is it the business? If the position of the States is that the consumer owes the tax, then why do they not have any forms or instructions to pay it? I have yet to see a single State make a serious effort to inform citizens that they have a duty to pay this tax.

In fact, last week I talked to a senior tax representative in California, which has one of the most sophisticated revenue gathering authorities in the country. That representative candidly admitted to me that there was no form to pay this tax and if I would like to

pay it I should send a note to the commissioner with a check for the proper amount.

Now, if the position of the States is that the business owes the tax, and that seems to be their position, I fail to see that line of logic. Why should a business in Florida, for example, pay sales tax to California? The Florida business does not benefit from police and fire protection of its property, so I do not see the logic there. Our country has a long tradition of opposition to taxation without representation. Requiring an out-of-State business to collect and pay a tax to another State goes squarely against this principle.

Unfortunately, it is a fact of life that tax collection agencies occasionally become a bit heavy-handed in their enforcement tactics. We have seen this with the IRS and we have seen it with local authorities. Imagine the temptation for a State tax collection agency, say, in California to harass a business from Kansas or Florida, knowing full well that this business faces substantial administrative burdens in challenging the assessment and going to court to fight it. Finally, that business in another State has no representation in the legislature at all.

We have seen in this tax collecting season a report by the General Accounting Office that indicates that fully 37 percent of IRS oral advice is either incorrect or incomplete. IRS is notoriously lax in answering questions promptly and correcting its errors.

The fundamental question in my mind is why should Congress require the IRS to take on another administrative burden for the States, when it has so much to do—the IRS, that is—in straightening out its act for the American taxpayer. Will the States pay for this new service? No. We think that the IRS budget should be aimed more at taxpayer service and not aimed at collecting taxes for the States, when the States have not even tried to collect the tax on their own.

In conclusion, Mr. Chairman and members of the committee, this is a State tax problem and not a Federal one. We urge you to reject this bill and similar legislation.

Thank you very much.

[The statement of Mr. Keating follows:]

STATEMENT OF

DAVID L. KEATING
EXECUTIVE VICE PRESIDENT
NATIONAL TAXPAYERS UNION

ON

H.R. 1242
THE INTERSTATE SALES TAX COLLECTION ACT OF 1987

BEFORE THE

SUBCOMMITTEE ON SELECT REVENUE MEASURES
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES

MAY 13, 1987

Mr. Chairman and members of the Committee, thank you for the opportunity to testify on H.R. 1242, the Interstate Sales Tax Collection Act of 1987. I appear to oppose this bill and similar bills on behalf of the 150,000 members of the National Taxpayers Union. H.R. 1242 is bad tax policy, will raise taxes, will reduce consumer choice, and will add new administrative burdens on an Internal Revenue Service that has substantial taxpayer service problems.

Make no mistake about it, this bill proposes a tax increase on the American consumer. But it would be an odd tax increase because if Congress approves it, Congress gets the blame but the tax revenues go directly to state governments that impose sales taxes.

The U.S. Supreme Court has sensibly ruled that the states have no authority to impose taxes or duties on persons totally outside their borders. However, the Supreme Court has ruled that if a company has a business presence, or nexus, in a state then that state may require the company to collect and remit the sales or use tax, even if the sale is made across state lines. Companies that do not have this business nexus with the state are under no obligation to collect the tax. Thus many states now have unenforceable and unconstitutional use taxes on their books. The appropriate state response should be to repeal these taxes -- taxes that are not being collected today anyway. Instead, we have the sorry spectacle of state governments asking Congress to vote a tax on the nation's consumers.

Use taxes are tariffs on interstate commerce, and states are asking Congress to make national marketers perform the custom house duties for them. It is certainly not fair to make out-of-state companies perform this questionable service, and it is not even fair to levy the use tax in the first place.

A sales tax is nominally on the consumer but is actually on the sales transaction since it affects what the seller can charge and what the buyer must pay and can only be levied by the state with jurisdiction over the sale. This is as fair as any tax since both the buyer and seller benefit from state services and protections which made the sale possible.

In a mail order situation the sale occurs outside the taxing state, and the state where the purchase is shipped provides no services to the seller. This mode of retailing does not burden that state's services, but it does depend upon the U.S. Postal Service and other common carriers and the seller pays for those services. It would be unfair to require the seller to collect the use tax in this situation.

H.R. 1242 would allow any state or local government to require an out-of-state retailer to collect a sales or use tax on any property

subject to such taxes delivered to that state or local government area. Certain retailers would be required to file information returns with the Internal Revenue Service detailing the sales to each state and other information the IRS may prescribe. Such information would be available to the states.

WHO OWES THE TAX?

Does the consumer or the business owe the tax? If the position of the states is that the consumer pays the use tax, then the states owe this Committee answers to several questions. Why don't more states inform taxpayers of their obligation to pay this tax? Why don't most states have forms and instructions for consumers who supposedly must pay this tax?

I have reviewed several states' income tax instructions for individual taxpayers and have yet to see a single state make a serious effort to inform its taxpayers about use taxes they may owe. Why? I don't know. It's certainly not for simplification reasons. Many state income tax forms and instructions are notoriously complicated. It wouldn't be difficult for states to add income tax form instruction information alerting taxpayers that they may owe use taxes.

A telephone call to revenue gathering authorities will likely produce confusion to any taxpayer who tries to pay the tax. I recently called the California Franchise Tax Board and the Board of Equalization, two of the nation's most sophisticated state tax collecting agencies. After I finally found someone who even knew what I was talking about, a senior tax representative candidly admitted that there was no form to pay this tax and that the taxpayer who wishes to pay the tax should simply send a letter to the Commissioner with a check.

One must wonder whether the states really think anyone owes this tax since few states haven't even bothered to publish a form for it. Designing a form for the use tax is not very complicated. The form would only be a few lines long.

Does the business owe the tax? Judging from the response of the state revenue authorities, it would appear that they believe that the out-of-state business owes the tax, not the in-state consumer. I fail to see why a business based out-of-state with no presence in the state should pay taxes to that state. Why should a Florida business, for example, pay sales taxes to California? The Florida business does not benefit from California police or fire protection of its property. So why should it pay taxes to California? The U.S. Supreme Court says it shouldn't have to.

This is reasonable. Our country has a long tradition of opposition to taxation without representation. Requiring businesses to collect and pay this tax goes squarely against this principle of tax fairness.

It is a fact of life that tax collecting agencies occasionally become heavy handed in their enforcement tactics. Imagine the temptation for state collecting agencies to harrass out-of-state businesses, knowing that these businesses have no representation in the legislature and face substantial additional burdens when making adminstrative appeals or filing a lawsuit.

STATES TO CONGRESS: VOTE NEW TAXES FOR US.

Why do the states want Congress to impose this tax? Could it be that state politicians want Congress to take the political heat? State politicians know imposing and collecting this tax would be enormously unpopular. Most consumers don't think that out-of-state companies should have to pay taxes for deliveries in their states. If the states tried constitutional means to impose and collect these taxes on their own, it would irritate their constituents. I suspect that state politicians prefer that Congress pass the law causing these taxes to be imposed and collected. Thus the taxpayer outrage at this new tax will be directed toward Congress, not them.

NEW ADMINISTRATIVE BURDENS ON THE IRS, BUSINESSES

A recent report by the General Accounting Office indicated that fully 37 percent of IRS oral advice is wrong or incomplete. In addition, the IRS is notorious for not answering correspondence quickly or correcting its errors. Why should Congress add another administrative burden on the IRS when it has so much work to do to improve taxpayer service? The IRS claims its budget is already squeezed. Will the states pay for this new service? No. Congress should improve taxpayer service and reduce IRS errors before assigning new administrative burdens to the IRS on behalf of the states.

This bill also would impose substantial administrative burdens on mail order businesses. Anyone who has ever operated a business knows that government paperwork burdens are already substantial. If the bill becomes law, mail order businesses would fill out as many as 184 additional tax returns per year.

This new administrative burden would be significant and will undoubtedly result in the result in the reduction in the size of the mail order industry, thus cutting consumer choices and reducing competition.

In conclusion, this is a state tax problem, not a federal tax problem. It would be unfair for Congress to allow a state to impose taxes on persons without representation in that state. The action by the states over the past 20 years demonstrates the states do not believe that this tax is currently owed by anyone. We urge you to reject this bill and similar legislation.

DK7:34

Mr. DORGAN. Mr. Keating, thank you very much for your testimony.

This panel has waited a good long while to testify and there is a vote on the floor. It is the intention of the Chair to recess for 15 minutes, come back, hear the final two statements on this panel and then ask a number of questions that I would like to ask. I appreciate the fact that you have been very patient with us today, so if you would be patient just a while longer, I think we can complete this hearing upon our return without another vote.

With permission of the minority member, we would recess until 2:40, that is 15 minutes from now.

[Short recess.]

Mr. DORGAN. The subcommittee will be in order.

The Chair will next hear testimony from Mr. William T. End, executive vice president, L.L. Bean, Inc.

Mr. End.

STATEMENT OF WILLIAM T. END, EXECUTIVE VICE PRESIDENT, L.L. BEAN, INC., FREEPORT, ME

Mr. END. Thank you, Mr. Dorgan.

My name is William T. End, and I am the executive vice president of the Maine mail order firm, L.L. Bean, Inc. Both the company and I appreciate the opportunity to testify today before your subcommittee.

L.L. Bean is a mail order retailer of outdoor equipment clothing, footwear and equipment. The company was founded in 1912 by an outdoorsman by the name of Leon Leonwood Bean, and continues today to be privately owned by the Bean family.

Today, L.L. Bean distributes more than 75 million catalogs annually to customers in all 50 States. We have sales in excess of $300 million a year, and the company employs over 2,200 people. All of the company's facilities are currently located in the State of Maine. We have a retail store, a manufacturing operation, a distribution center, a telephone operation, and our corporate headquarters in Freeport, ME.

The purpose of my testimony is to provide this subcommittee with a direct marketer's ground-level view of the burdens and inequities which the proposed legislation presents.

We believe this legislation presents a relatively heavy burden on mail order retailers who in turn receive none of the benefits resulting from the collection of State taxes. For a point of sale retailer, the collection of sales tax is a relatively easy matter. The tax is simply added to the sale price of the product being sold and collected at the register. Sales people need consider the rules of only one State and there is no confusion over applicable tax rates, which items are exempt from tax or how the tax should be accounted for and remitted to the State treasury.

A mail order company such as L.L. Bean or whoever would incur a substantial additional cost in complying with the tax laws of 46 separate jurisdictions. First of all, and most importantly, a mail order retailer such as ourselves would have to advise the customer of the tax rates and all of the exceptions for each of 46 different taxing jurisdictions. The only way we have of providing this infor-

mation is providing it through our catalog. We have to include a complicated set of instructions setting forth rates and exemptions for those jurisdictions.

We have estimated that the devoting of catalog space to explain the sales tax rates and exceptions of the 46 taxing jurisdictions would cost the company over $950,000 during 1987 alone. We also see a loss of roughly $9.5 million in opportunity costs due to lost sales by reason of devoting valuable catalog space for that purpose.

Second, all State sales tax laws provide that if the retailer responsible for collecting the tax from its customer fails to do so, the retailer itself is responsible for payment of the tax. The shop keeper simply collects the tax at the cash register. It is not faced with postsales collection problems. This would not be the case, however, for a mail order company like L.L. Bean. Last year, in excess of 2 million of our customers paid for their purchases by personal check.

Under the proposed legislation, if the customers did not include the sales tax with their payment or if they improperly computed the tax, L.L. Bean would either have to refuse to deliver the product ordered, pay the tax itself, or attempt to collect the tax after we had shipped the goods. This postsales collection effort would run into the costs of hundreds of thousands of dollars. In many instances, the administrative costs of collecting the tax would be greater than the tax itself.

Third, under the proposed legislation, a direct marketer would have to contend with the use tax laws of 46 different States, plus the District of Columbia. L.L. Bean, for example, is subject to 46 possibly different tax rates, 46 separate sets of exemptions, 46 methods of remittance, 46 different timetables for remittance, 46 different auditing procedures, and potentially 46 different audit visits. L.L. Bean would have to monitor the changes to all of these tax laws and regulations of 46 jurisdictions, where our only contact with these jurisdictions is through the mail.

As an example, L.L. Bean has no connection with California other than the fact that it sells merchandise to residents there. It has been provided no services by California and realizes no benefit from the expenditure of sales revenues. H.R. 1242, however, would require us to become tax collection agents for California as well as 45 other jurisdictions, although we are not doing business there and neither receive nor become eligible for the services which these governments customarily provide to their instate retailers. These are government services such as police and fire protection, maintenance of highways, and job training programs for employees.

We do not take lightly the concern of any State tax administrators for finding new sources of tax revenue. The problem is that it poses disproportionately heavy administrative demands on mail order companies when compared to the efforts required of instate retailers. It should be remembered that the State's sales or use tax is imposed on the customers and not on the out-of-State vendors. Nevertheless, the Dorgan bill would impose difficult and damaging burdens on mail order retailers.

The harm and expense in the industry should be carefully considered before imposing that duty. The equities of this legislation

might be different if the States were proposing a uniform sales tax on all mail order sales, with a uniform set of exemptions, a uniform and centralized system of reporting and remittance, and uniform audit procedures.

I think one point that was made earlier in the testimony which is an extremely important one is that the States have done very little in the way of trying to collect these taxes on their own.

If in fact the dollars involved are $1 to $1.5 billion, the States at this point do not even make an effort in the tax forms that they send out for State income tax to request this taxation on the part of the consumer. I believe a good portion of the tax would be paid on a voluntary basis if this effort were made.

Alternately, I think the States had an opportunity to get some support from the mail order companies if they were able to make this a more reasonable administrative burden on the mail order companies. This has not been done and in my judgment this legislation is extremely burdensome to us.

L.L. Bean has sought to comply with and has followed every applicable State and Federal regulation. We collect tax and we remit the Maine sales tax. We are very much troubled, however, by H.R. 1242 because it would place a heavy burden and costs on us to act as an agent of distant States where we have no connection and where we realize no benefits.

L.L. Bean is not the kind of company that frequently voices opposition to pending legislation. This bill, however, would have such a major impact on the way we do business that we felt it important to make our concerns known.

Thank you for giving me that opportunity.

[The statement of Mr. End follows:]

STATEMENT OF WILLIAM T. END
EXECUTIVE VICE-PRESIDENT
L.L. BEAN, INC.

My name is William T. End, and I am Executive Vice-President of the Maine mail order firm, L.L. Bean, Inc. Both the company and I appreciate the opportunity to provide testimony regarding the Dorgan Bill, H.R. 1242, that is before the Subcommittee today.

L.L. Bean is a mail order retailer of outdoor equipment, clothing and sporting goods. L.L. Bean is celebrating its 75th year of existence this year and was founded in 1912 by an avid hunter and outdoorsman, Leon Leonwood Bean. Mr Bean's descendants continue to own the controlling interest of the company.

The Company began by selling, by mail, the rubber top, leather bottom Maine Hunting Shoe. Its first mailing was to holders of Maine hunting licenses who resided outside the State of Maine. L.L. Bean was one of the first users of the U.S. Postal Service's Parcel Post Service, which began on January 1, 1913. At the time, the Postal Service charged a penny a pound for items shipped.

Today, L.L. Bean distributes more than 75 million catalogs annually to customers in all of the fifty states and in many foreign countries, and we have sales in excess of three hundred million dollars a year. The Company employs over 2,200 persons.

Despite its growth, L.L. Bean's approach to retailing has remained virtually unchanged. We have only one retail store, which has always been located in Freeport, Maine, and is now visited annually by more than two million people. Similarly, all of our manufacturing, distribution and other facilities are located within the State of Maine. Although Freeport, Maine may be remote from many of the major consumer markets in the United States, this country's postal system, telecommunications network and transportation facilities have allowed us to reach a national market for our products. For example, Bean telephone representatives in Maine handled 5.2 million calls in 1986. L.L. Bean has truly been a beneficiary of our unobstructed national market.

Consumers benefit from a healthy mail order industry as well. People living in rural areas, working couples without time or child-care to permit shopping, all have access to a broad variety of products through mail order. All of us have a greater and more competitive choice of purchasing options through the opportunities created by direct marketing. L.L. Bean's success demonstrates that high quality, good value and excellent service to our customers can be a formula for success even if a manufacturer and retailer is not located in one of the urban centers.

I am not a lawyer so I cannot testify about the constitutional questions raised by this legislation. I would like to provide this Subcommittee, however, with a direct marketer's ground level view of the burdens and inequities which the proposed legislation presents.

The proposed legislation places a relatively heavy burden on mail order retailers who, in turn, receive none of the benefits resulting from collection of state taxes. For a point of sale retailer, collection of sales taxes is a relatively easy matter. The tax is simply added to the sales price of the product being sold and collected at the register. Sales personnel need con-

sider the rules of only one state. Consequently, there is no confusion over the applicable tax rates, which items are exempt from the tax, or how the tax should be accounted for and remitted to the state treasury.

A mail order company such as L.L. Bean, however, would incur substantial additional costs in complying with the tax laws of 46 separate jurisdictions. First, a mail order retailer such as L.L. Bean would have to advise its customers of the tax rates and exemptions for each of 46 different taxing jurisdictions. Since the only way L.L. Bean has for providing this information is in its catalog, we would have to include a complicated set of instructions setting forth rates and exemptions for the various states. Moreover, special instructions would have to be provided for the situations where the person ordering the goods lives in one state, but he or she is sending the goods to a resident of another state. A more casual approach to collection of sales and use taxes, such as simply requesting the customer to include the applicable sales tax, would most likely result in substantial non-conformity and present a significant financial exposure to a company such as L.L. Bean in subsequent tax audits.

L.L. Bean has estimated that devoting the catalog space to explain the sales tax rates and exemptions of the 46 taxing jurisdictions would have a direct cost in 1987 of $950,000 and an opportunity cost of $9.5 million of lost sales by reason of devoting valuable catalog space for this purpose.

Furthermore, we would be presenting our customers with complicated information. The success of direct marketing depends upon making the transaction as simple as possible. Once we make mail order complex and confusing for our customers, we discourage their doing business with us. Many people, including myself, are not familiar with their own state's list of products exempt from state sales taxation.

For example, some states exempt apparel for infants from sales tax, while other states exempt sportswear from sales tax. To try to draw the line in one particular state as to what constitutes a taxable item in that state is hard enough. To do that for each of the 46 jurisdictions would be a formidable task.

An additional illustration of the difficulties that would be caused by the proposed legislation is the taxation of shipping charges by some states and the exemption from the sales tax by other states. L.L. Bean itself does not add a separate charge to its customers for shipping expense but instead charges one price for each item and includes shipping expense as part of its costs of doing business. This method of pricing is done, in part, to make the ordering of merchandise by mail as simple as possible to its customers. It would be very difficult for L.L. Bean to explain in its catalogs how customers should calculate the tax if this method of pricing were retained by L.L. Bean.

Second, all state sales tax laws provide that if the retailer responsible for collecting the tax from its customer fails to do so, the retailer itself is responsible for payment of the tax. The shopkeeper simply collects the tax at the cash register. It is not faced with post-sale collection problems. This would not be the case, however, for a mail order company. Two million of our customers paid for their purchases by personal check. Under the proposed legislation, if customers did not include the sales tax with their payment, or if they improperly

computed the tax, L.L. Bean would either have to refuse to deliver the product ordered, pay the tax itself, or attempt to collect the tax after we have shipped the goods. These post-sale collection efforts would run into the hundreds of thousands of dollars. In many instances, the administrative cost of collecting the tax would be greater than the tax itself.

Third, under the proposed legislation, a direct marketer would have to contend with the use tax laws of forty-five different states plus the District of Columbia. L.L. Bean, for example, would be subject to 46 possible different tax rates, 46 separate sets of exemptions, 46 methods of remittance, 46 different timetables for remittance, 46 different auditing procedures, and 46 different auditor visits. L.L. Bean would have to monitor the changes to the tax laws and regulations of 46 jurisdictions where our only contact with these jurisdictions is through the mail. As I understand it, the rules and regulations of each jurisdiction change frequently.

L.L. Bean has no connection to California, for example, other than the fact that it has sold merchandise to residents there. It has been provided no services by California and realizes no benefit from the expenditure of state revenues. H.R. 1242, however, would require us to become tax collection agents for California as well as 45 other states although we are not doing business there, and neither receive nor become eligible for the services which these governments customarily provide to their in-state retailers. The various government services which benefit local businesses are too numerous to cite in this testimony, but, simply by way of example, they include police and fire protection, maintenance of highways and job training programs for employees. L.L. Bean receives these services from the State of Maine, and, consequently, it is only fitting that we provide a reciprocal service to Maine by assisting it in collecting sales taxes on on purchases from our retail store in Freeport, Maine, and mail order purchases by Maine residents.

Our only contact with states other than Maine is through the shipment of catalogs and goods. As a business decision, L.L. Bean has chosen to locate all its facilities in Maine. We neither ask for nor receive the services which other states provide to their local businesses.

We do not take lightly the concern of many state tax administrators for finding new sources of tax revenue. The problem with any "quick fix" approach to the out-of-state vendor issue, however, is that it imposes disproportionately heavy - indeed discriminatory - administrative demands on mail order companies when compared to the efforts required of in-state retailers. It should be remembered that the state sales or use tax is imposed on the customers, not on the out-of-state vendor; nonetheless, the Dorgan Bill would impose difficult and damaging burdens on mail order retailers. The harm and expense to the industry should be carefully considered before imposing that duty.

The Bill does not eliminate the confusion and disparaties resulting from 46 different tax systems. The equities of this legislation might be different if the states were proposing a uniform sales tax on all mail order sales, with a uniform set of exemptions, a uniform and centralized system of reporting and remittance, and uniform audit procedures. My understanding is that the states have opposed such approaches. It would seem to me to be unfair for the states to insist upon maintaining their right individually to fashion and administer their tax systems,

but at the same time look to Congress to assist them in requiring companies located in distant areas to collect taxes.

L.L. Bean has sought to comply with, and has followed, every applicable federal and state regulation. L.L. Bean collects and remits the Maine sales tax. We are very much troubled by H.R. 1242 because it would place a heavy burden and cost on us to act as an agent of distant states where we have no connection and realize no benefits. L.L. Bean is not the kind of company that frequently voices opposition to pending legislation. This Bill, however, would have such a major impact on the way we do business that we felt it important to make our concerns known. Thank you for giving me the opportunity to testify here today.

Mr. DORGAN. Thank you, Mr. End.

Next we will hear from Mr. Heath Kline, president of Priority 1 Electronics.

Mr. Kline.

STATEMENT OF HEATH KLINE, PRESIDENT, PRIORITY 1 ELECTRONICS, CHATSWORTH, CA

Mr. KLINE. Thank you, Mr. Chairman.

I am here today to oppose H.R. 1242 and any similar legislation that would require mail order companies such as mine to collect sales tax. The reason for this is quite simple. It will put me out of business, and the reason for that is with the lack of uniformity among the 50 States, our company would be expected to know what items and what customers are taxable.

For example, in my first exhibit supplied to the committee, I have a chart showing just spare parts, with 32 different variations for each State as to whether or not that part is taxable. Multiply that by 50 and you can see why no computer could possibly manage it. Then we get into the problem of interpreting purchase orders.

I have purchase orders attached from the University of Arkansas, which is the State institution there and it has a tax code of "T" on one purchase order, another purchase order has a tax code of "0," and yet another one has a tax code of "R." Can anyone please explain to me what that means?

There is just no way that we could possibly comply with that burden. Then we get into another problem; if the MultiState Sales Tax Commission were to have their way, we would not only be responsible for collecting future taxes but we would also be liable for past taxes. With the burden of compliance and remitting placed squarely on our shoulders, it is one too large to handle for my small business.

For example, during my last California sales tax audit, they found a $12 mistake. Extrapolating that out over a 3-year period of the audit, I was handed a bill for $10,000. Now, there is no way that I could possibly have the auditors from 46 States coming in and visiting me and imposing those kinds of burdens on us.

We would quite simply make more mistakes outside of California than we do here. Another issue that has not been raised today is the impact that it will have on the Federal Government and its sources of revenue. For example, we have heard about the 800 phone numbers here today. This is the preferred method of ordering. The bulk of our orders are received over 800 number, about 90 percent.

Well, last year we paid in excess of $24,000 in Federal excise tax on just our incoming 800 number. If this bill passes we would not be in this business any longer and paying that revenue. The $24,000 does not include the taxes paid when the customers that called us on their dime, and all the calls that we made out to our customers. If all these calls were included, the Federal Government would lose $50,000 in excise tax revenue from Priority 1 Electronics alone.

In addition, the bulk of my solicitations and those of most of the people here is done via, if you will, third class mail. Third class

mail is the only profitable mail service that the post office handles, and it is used to subsidize first class mail. If the third class volume were to drop off, Congress would be asked to supply even larger amounts of revenue subsidies for the Postal Service, to say nothing of the fact that consumers would be burdened with the added cost of postage. Instead of having a 25-cent stamp next year, perhaps it will be a 35-cent stamp.

Another issue is the fact that we sell some very specialized products. Our products are primarily bought by universities, groups like NASA, defense contractors, used in research and development and so forth. If this product was no longer available through the mails, it would not be available to these customers. Although I operate five retail stores in the high technology centers of California, even I do not have enough market demand to carry those products there. The reason why we can afford to bring these products to market and make them available is because we have a national customer base. If that was removed from us, we would no longer offer these products. I do not see any retailer prepared to pick up that gauntlet from us.

For that reason, without question, I have to oppose this bill because it would cost more money than it would raise, put an unnecessary burden on the various businesses associated with it and government and I would very much appreciate a no vote on this and any other similar legislation. Thank you.

[The statement of Mr. Kline follows:]

Testimony of Priority 1 Electronics
on HR1242
before the
Select Revenue Subcommittee
of the
House Ways and Means Committee
May 13, 1987
delivered by
Heath Kline, President
Priority 1 Electronics
21622 Plummer Street
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Introdction

Ten years ago when I was 21 years old I founded Priority 1 Electronics as a "mail order" only business from the back bedroom of my parents' home. I invested $832 of my savings to start the company. My only employee was my high school age brother who worked for love not money.

I started the company with the idea of filling a niche market for supplying state-of-the-art electronic components to schools, universities, government and research & development departments of Fortune 500 companies. In addition we would sell to entrepreneurs and sophisticated hobbyists, a market segment that had been almost totally ignored.

Ten years later Priority 1 Electronics now operates five retail stores throughout California. In addition we still do a significant amount of out-of-state mail order business. We employ 110 people. Seventy of these people owe their jobs directly to our mail order business. We currently sell a wide variety of personal computers, accessories, software and components.

Our sales have grown from less than $40,000 the first year to almost $30,000,000 this year. Several times Inc. Magazine has included Priority 1 Electronics in their list of 500 fastest growing private companies. We have been rated as high as 31 on the Inc. list.

We have obviously been successful, but do not get the idea that this is a get rich quick business. Our after tax profits have averaged less than 1%.

I am not going to discuss the constitutionality, merits or fairness of having out-of-state merchants collect sales taxes for states in which they maintain no presence. Instead I am going to discuss how the current systems works and the devastating impact the proposed changes now under consideration would have on small businesses such as mine.

I. THE LACK OF UNIFORMITY AMONG THE FIFTY STATES

Under current law a merchant is only required to collect sales tax for the states where a physical presence is maintained. Typically this would mean a retail outlet, warehouse, manufacturing plant, or the use of a sales force in the state. This is well understood and universally accepted. I am required to collect and remit a sales tax ranging from six to seven percent on all my California sales unless the transaction is "exempt" under California Law. The rate varies within California because some of its 58 counties have imposed an additional sales tax to finance such local concerns as rapid transit and highway construction.

The major difficulty for businesses such as mine under a system of collecting sales taxes nationwide would be (1) how to determine which goods and services are taxable in each state; and (2) how to know when certain sales or customers are tax exempt.

A. Which Goods And Services Are Taxable?

California law requires that sales tax be paid on all sales or use of tangible property except some food, drugs, and newspapers. This varies from state to state. Something that maybe sales tax exempt in Texas, such as children's clothing, maybe taxable in most other states.

As a further example of the wide variation among the states, attached as Exhibit 1 is a chart from our largest vendor advising its dealers on whether extended warranty service contracts and repair work are taxable in each state. This would present major difficulties for firms such as mine. We sell a large number of complete computer systems that are made up of components from several manufacturers. Often the "package" price includes a labor charge. In other instances, there may be a separate labor charge for further customization. As the chart indicates, it would be virtually impossible for the average employee to know which portions of the sale are taxable in some states.

This points out the further problem of each state having to disseminate information about what is taxable to merchants nationwide. For most items, the merchant will not be so fortunate as to have a chart like Exhibit 1. Even if this information were readily available, there is the further problem of how to use and maintain it. Most mail order firms such as mine are highly automated using computers to generate invoices and maintain inventory records. It would require hundreds of thousands of dollars and months of programming time just to "code-in" to the computer what is or is not taxable in each of the fifty states. How would we interpret P.O.'s from the University of Arkansas with tax codes of "R", "O" and "T" (Exhibit 2)?

B. The Problem of Tax Exempt Sales

In addition to each state having its own rules as to what goods and services are taxable, each state has its own rules as to who must pay the state sales tax, or what they must do to avoid paying it. It would be virtually impossible for the out-of-state merchant to know what is a tax exempt sale or customer.

California has two basic exemptions for (1) sales to the United States government; and (2) sales to manufacturers or retailers who will in turn "resell" the property to others who will collect the tax from the ultimate purchaser. As a general rule all others, including state government agencies, must pay the state sales tax. In other states, the state government

itself and some nonprofit organizations are exempt from the state sales tax. Each state has its own unique procedures for each type of sale.

1. Sales under U. S. government contracts. It is universally accepted that sales made directly to the federal government are exempt from state sales taxes. In addition, sales to universities or government contractors that are federally funded are also tax exempt. The problem for business is how to know which sales are taxable and which are not.

We have a major problem with the University of California and major defense contractors such as Hughes, Litton, Lockheed, Rockwell and others. When we take an order from them they will tell us over the phone and indicate on the confirming purchase order that the order is taxable. We charge them tax only to have them pay the invoice months later short the tax. When we call to question the short payment we are told that this was for a U.S. Government project and therefore tax exempt. We tell them their purchase orders states that the order is taxable and in order to avoid paying the tax we need a corrected purchase order and a valid California resale card on file. We have long since paid the tax to the state. It is almost always impossible to get a corrected copy from these bureaucracies. Regardless, by this time we have already paid the tax to the state. If we do get a corrected purchase order, we then must credit and rebill the customer less the tax. If we can't get the corrected information we must still pay the tax as you will soon see. Whatever profit was associated with the sale is lost in the middle of this process.

This problem, which is now limited to our home state of California, would be multiplied fifty times if we were required to collect sales tax for each state. This would also add to the general confusion as to "who" is taxable. Sales to the University of California are taxable unless federally funded while sales to the University of Chicago are always tax exempt (Exhibit 3).

2. Resale cards and procedures. To prove that a transaction was for "resale" we must have from the customer its purchase order that contains the words "For Resale" together with its California Sellers Permit number printed on the purchase order signed by an authorized agent. In the alternative, we must have purchase order marked "For Resale" together with a valid "resale card" on file with the customer's permit number and signature. California will accept no other wording. As will be discussed further below, if the merchant does not have the proper valid documentaion, the merchant must pay the sales tax. California and all other states put the burden on the seller to remit the sales tax unless the seller can prove the exemption.

If a merchant must collect sales tax from all fifty states, he must also collect resale cards from all fifty states as well. As you might guess, each state has its own form with its own requirements. In an apparent effort to adopt a "universal" resale certificate, the Multistate Tax Commission which represents twenty-seven states has adopted the "Uniform Sales & Use Tax Certificate Multijurisdiction," a copy of which is attached as Exhibit 4. However, this form is far from universal. Six of these twenty-seven states, including California, Florida and Ohio will not accept this form. Other states, such as Wisconsin will only accept it for limited types of exemptions. This is typical of the lack of uniformity among the states, even within those represented by the Multistate Tax Commission.

In many instances it may be difficult to obtain the proper resale certificate or purchase order with the necessay

information. Although we are a "mail order" business, the majority of our out-of-state orders are taken over the telephone using toll-free "800" numbers. In the future, we will be forced to wait for the confirming order or resale card to arrive in the mail before shipping as we now do with our California customers. Once the document does arrive, our clerical workers must scrutinize it to see that it is in the proper form. This is often difficult for California and would prove impossible for fifty states.

In all cases, it is the responsibility of the merchant to ensure that he has the proper resale card or certificate from his customers. Merchants will have to maintain a virtual library of blank forms from each state. This will be exceeded only by the fifty sets of completed resale certificates.

3. "Direct Pay" and other procedures. In addition to government contract sales and resales discussed above, some states have unique procedures for collecting their sales tax. For example, in some states such as Michigan and Florida, some large businesses like General Motors pay sales tax on their purchases directly to the state rather than through the merchant (Exhibit 5). Therefore sales to some GM divisions in some instances may be taxable while others may not be.

II. THE PROBLEMS OF ENFORCEMENT AND IMPLEMENTATION

Under the various proposals now before Congress, the "nexus" requirement would be changed to allow the states to require out-of-state merchants to collect and remit their state sales tax. To see what type of havoc this would cause, the Congress need only look to the proposed implementing agreement from the Multistate Tax Commission and the states' current audit and enforcement procedures.

A. Proposals From the Multistate Tax Commission.

One of the major proponents of the proposed changes is the Multistate Tax Commission ("MTC"), an organization of twenty-seven member states. The primary objective of the MTC is to assist its member states in requiring out-of-state merchants to collect and remit sales tax. The MTC has prepared a model "Agreement for Collection and Remittance of Use Tax" to be signed by mail order companies, the MTC, and representatives of each of the MTC member states. Under the proposed agreement, the mail order company would agree to begin voluntarily collecting and remitting sales tax to the member states. If the merchant complies with all of the terms of the agreement for eight years, the member states would forego auditing the merchant for the eight years prior to the signing of the agreement. If the merchant is unable to comply, he has now waived any applicable statute of limitations and would be subject to audit from each of the member states. The terms of the proposed MTC agreeement demonstrate why nationwide collection of individual states' sales tax would be an impossible burden on business.

The following is a summary of some of the more egregious terms of the MTC agreement. This list is by no means exhaustive.

1. Local Taxes. It is important to note that the sales tax rate may not be uniform within the state. Local government units often impose an additional tax. The out-of-state merchant would be responsible for knowing and collecting these varying taxes.

Unfortunately, there is no sure way to know what that rate is and where it applies. For example, in California, some of its fifty-eight counties have imposed an additional tax over and

above the base rate of six percent. However, the State Board of Equalization, the state agency responsible for collecting and administrating the sales and use tax, does not publish a "break-down" of where the different rates apply. We have tried to obtain this information on numerous occasions, only to be told it is not available. Instead, we have been forced to make educated guesses using a zip code map. If we should guess wrong, we are responsible for remitting any underpaid tax.

If we are unable to obtain this information in our home state, what is a merchant from Texas supposed to do to find out what the California tax rates are? Although merchants are required to collect local taxes, there is no corresponding obligation on the part of the MTC or the states to provide the necessary information to do this. One alternative under discussion would be for the MTC states to accept a uniform tax rate from out-of-state merchants. However, several MTC states' laws would prevent them from accepting such a proposal to forego local taxes. Therefore the out-of-state merchant would have the obligation to report his sales by city or county to many states.

I understand that some of the proposals now before Congress would require a flat rate for out-of-state sales. This would confuse many customers who would pay one rate on local purchases and another rate for out-of-state purchases.

2. Access to books and records. Under the MTC agreement, each state would have access to a company's books and records to verify that it is properly collecting and remitting the tax. As will be discussed more fully below, the typical sales tax audit may last six to eight weeks and requires numerous man hours to gather necessary information and documents. If each state could perform its own audit, a merchant might be under audit from one state or another at all times. Several full time employees would be needed to assist the auditors.

3. Publication of sales tax information. The MTC agreements requires merchants to inform their customers that their purchases are subject to the applicable sales tax. As noted above, there may be no practical way to know what that rate is for each customer's locations or whether that customer is subject to tax at all.

4. The merchant's duty to collect the tax. Notwithstanding the wide variation in tax rates and procedures discussed throughout this testimony, the burden is always on the merchant to collect and remit the proper tax. Customers often remit too little, or too much requiring expensive refund checks to customer. If the customer doesn't send enough, we must return his order and risk that he will then place it elsewhere or make-up the difference ourselves. Either way, the increased handling cost will reduce our profits and lead to higher prices to cover the increased costs. In many states the merchant must pay the tax even if the customer does not pay the merchant (Exhibit 6).

5. Resolution of disputes in each state. Under the MTC proposal, the agreement would be subject to interpretation by each state's courts. By signing the agreement, the merchant submits himself to the jurisdiction of each state's courts to interpret and enforce the agreement. If a merchant had a dispute with one of the MTC states, he would have to hire local counsel in that state to defend himself. If the dispute were with more than one state, each state would determine the dispute separately. For the merchant, he may have to defend himself in each of twenty-seven states at great expense. In each instance, the out-of-state merchant would be pitted against the Attorney General of that state in that state's local courts. There is the

very real danger of inconsistent judgments since each state's court could interpret the same language differently. The merchant has no voice in that state's government and no opportunity to protest heavy-handed enforcement techniques.

6. The threat of liability for prior years. The major incentive for merchants to sign the MTC agreement to voluntarily collect and remit sales tax for the various states is that if the merchant complies with the agreement for eight years, the states will forego audits and liability for back taxes for the eight years prior to signing the agreement. If the agreement is terminated or broken during that time, the states will forego the audit period on a prorated basis. Regardless of the surrender terms offered by the MTC, its is fundamentally unfair for the states to threaten or collect taxes for any prior years.

As the law now stands, the states may not require merchants to collect their state sale tax if the merchant has an insufficient "nexus" with that state. Notwithstanding the so called National Bellas Hess decision of the Supreme Court, the MTC has taken the position that merchants must collect the tax and are liable for unpaid taxes for prior years. The MTC has taken the further position that there is no statute of limitations for these unpaid back taxes. Death, dissolution or bankruptcy will not discharge this alleged obligation.

The MTC agreement requires the merchant to waive his Constitutional rights and Due Process guarantees to submit himself to the jurisdiction of another state and waive the statute of limitations, if any. Since merchants are not required to collect sales tax under the prevailing interpretation of the current law, few have. Furthermore, since sales tax was not required, merchants such as myself made no attempt to gather information on whether the sales would be tax exempt. As discussed above in greater detail, there are many instances where a particular sale or customer may be sales tax exempt if it can be supported by the proper documentation. It would now be impossible to gather the necessary documentation years later.

If the states were to now demand taxes for previous years' sales, the assessment would be paid in full by the merchant. I know in the case of my company, any significant liability for back taxes would force me out-of-business. I do not have the working capital or cash reserves to to pay sales tax on sales I made one to ten years ago. I am sure that any attempt to collect sale taxes for previous years would drive many companies like mine out-of-business.

B. The Sales Tax Audit or Do You Feel Lucky?

Some of the most unfair aspects the MTC proposal or any system of nationwide collection of sales tax are the draconian enforcement procedures. The most common of these is the compliance audit. I would like to share with the Committee my own personal experience of such an audit in the summer of 1985 in my home state of California and the devastating impact it would have if applied to all fifty states.

California like other states audits merchants for compliance with Sales Tax remittance using the statistical sampling method. The audit typically covers a three year period or less. The auditor asks for several days invoices at random from each of the three years under review. The auditor examines each of the invoices to make sure that the proper tax rate was used. That in itself is a difficult task because California has many local tax jurisdictions with different tax rates.

The auditor's next step is to examine all the invoices where

tax was not charged. The invoice itself will be examined for the proper information. Next the auditor will ask for the substantiating paperwork, the valid "California Resale Card" and/or the hard copy of the customers purchase order indicating that this transaction was indeed "For Resale" and that the other necessary information was contained on the Purchase Order.

If any of the above information is missing, incomplete, or invalid the auditor will disqualify the transaction. The auditor will treat the sale as if it were taxable. The auditor will then total all of the errors found and multiply that number by the number of days in the audit period, i.e., 270 business days per year to determine the amount of back taxes owed. California then imposes a 10% penalty and interest on the balance due.

By way of example during our case the auditor found a total of $12.00 in errors on his sample. The errors were the result of missing or incomplete resale cards. Due to the small size of the errors, the field auditor recommended that no further assessment be made. The audit supervisor would not accept the recommendation and gave us the "option" to pay back taxes extrapolated from the $12.00 errors or the auditor would return to conduct a further audit on a larger samples. Rather than face an additional six to eight weeks of disruption and run the risk of the state finding further errors, we elected to pay the assessment based on the $12.00 in errors. Using the formula outlined above we were handed a bill for $9,787.98! The state was magnanimous enough to wave the penalties because they thought our mistakes to be honest ones. Our previous audit, under similar circumstances netted the state $12,553.11. I was assured by the auditor in both instances that these were very small assessments for companies of our size and that I should consider myself lucky.

I doubt I would be so lucky with the other forty-nine states. If we were required to collect sale taxes for each state, our error ratio would no doubt be much higher. As noted above, there are too many variables from state to state concerning who and what are taxable. It would also be far more difficult to obtain and verify resale information from out-of-state customers. If each state were to audit our records using the statistical sampling method outlined above, the assessments on a few simple errors could drive us out-of-business.

C. Legitimate Business Would Be Discriminated Against Under The Proposed "Two Tier" Legislation.

One of the proposals now before Congress would exempt smaller companies with sales below a certain amount to be exempt from the requirements of collecting sales tax for all states. Such a proposal is fundamentally unfair and would be an open invitation to fraud and cheating. Using sales volume scale to determine which businesses would be required to collect state sales tax presents several unique problems.

1. Small firms would have an unfair advantage, because their prices would be automatically lower by the percentage of sales tax they don't have to collect. Further, there overhead would be substantially lower because they don't have the burden of complying with these regulations.

2. It invites fraud. Larger firms would have a strong financial incentive to under report their sales to avoid the onerous burden of collecting and reporting the tax to the fifty states. On the other hand, smaller firms would have an incentive to collect the tax and not report it if their sales fall below the minimum threshold. This would give the smaller

firm additional revenue on each sale, as well as avoiding the burden of compliance.

3. If business expansion means the loss of competitive advantage and the forced increase in overhead. What incentive is there to expand and provide new jobs? A two tiered system for collecting sales taxes is a negative incentive to a growing business.

III. THE EXPENSE TO BOTH THE STATE AND FEDERAL GOVERNMENTS FAR EXCEEDS THE REVENUE TO BE GAINED.

Everyone knows that these are difficult times for state an local governments. Cutbacks in federal funding over the past several years have shifted more of the burden for providing essential services to state and local governments. As the need for funding increases, the states have looked for new sources of revenue. The states now view the out-of-state merchant as one such source. Out-of-state merchants are an easy target because they are unable to vote or protest. Unfortunately, the current proposals are rather shortsighted. The costs to both the state and federal governments will far exceed the few marginal dollars of additional revenue to the states. The net result will be fewer jobs and fewer tax dollars for everyone.

A. Lost Revenue to the Federal Government.

1. Loss of federal excise tax revenue from telephone bills. Currently most interstate business is conducted over the phone. The phone bill is subject to a 10% federal excise tax. Last year we paid over $24,000.00 in federal excise tax on our 800 toll free order number for customer ordering! If we left or cutback on our mail order business and other firms did also, this would mean a tremendous loss of revenue to the federal government. The federal government would lose far more than the states are likely to gain. The current proposals are far from "revenue neutral" and would result in a net decrease in revenue to all concerned.

2. If a system of collecting sales tax nationwide is to have any chance of success, the federal government will ultimately have to step in and mandate a uniform set of rules and procedures to follow, much as it does in other areas such as unemployment insurance and welfare. This will only increase costs and decrease revenue.

3. The loss of business income and employee layoffs would result in lower federal income tax revenue from these sources.

4. Excise tax, and fuel tax revenue would be loss from delivery companies such as UPS, Federal Express, etc.

B. Increased Costs for State and Local Governments.

1. Increase in government personnel when the emphasis is on less government. Each state would need an army of auditors to review returns and criss-cross the nation to conduct audits. These auditors would then generate mountains of paperwork.

2. Revising state laws and procedures to follow federal model in interstate collection. If the federal government does mandate how the tax be collected, the states will have the added cost of compliance.

3. With so many jobs that are supported by the direct mail industry directly in the field, and support industries such

as printing, transportations, etc., a cutback in the industry would mean a loss of jobs which of course would mean a loss in income tax at all levels of government paid by these industries and their employees.

4. Increase in unemployment cost, and social services.

5. Business taxes paid by these companies.

6. States would also lose highway tax revenue.

IV. BUSINESS AND CONSUMERS WILL ALSO LOSE UNDER THE PROPOSED LEGISLATION

The state and federal governments are not the only losers under the proposed legislation. Business will bear the high cost of implementation and enforcement. Many will be forced out-of-business. This will lead to reduced competition and higher prices for consumers. Consumers will pay more for such things as telephone service, periodical subscriptions and higher taxes.

A. Increased Costs for Business.

1. Additional employees to complete fifty sales tax returns monthly -- six hundred each year. Other employess will be needed to maintain the file of fifty resale certificates. These employees will increase overhead without contributing to sales.

2. If a business is to have any chance of complying the varying laws of the fifty states, a substantial investment in additional computer hardware and software will be needed to store and maintain the required information in the form desired by each state or local government.

3. The expense of mailing and processing of various forms, which may not be warranted for small amounts (small sales to some midwest states).

4. Lost jobs and increased unemployment. It would be easier for me to operate my five retail outlets than to stay in mail order if this law is passed. I would be forced to layoff 70 of the 110 employees I currently employ. The outside services we use (printing and mailing services, etc.) would also be forced to layoff employees because they depend heavily on the business from mail order companies.

B. Higher Prices and Fewer Choices For Consumers.

1. Currently the majority of mail used in the direct mail industry is 3rd class. This is the only class of mail handled by the Postal Service that is profitable and in fact subsidizes 1st class mail rates. If the Postal Service lost 3rd class volume, it would mean an increase in postal rates.

2. Telephone companies would have to increase rates to consumers because of loss of volume from our industry which is heavily involved in telemarketing.

3. Tax burden currently paid by direct mail industry would have to be paid by others.

4. Consumers would loose the availability of a wide range of merchandise at traditionally very competitive prices.

5. Direct mail advertising subsidizes newspaper and

magazine subscription costs.

6. For many handicapped consumers shopping via mail is the only way to acquire merchandise.

7. Some speciality merchandise is only available via the mail.

Without question these programs would cost more money for the individual business and governments than it would bring in revenues. If this is an attempt to close legitimate mail order business down if the law is passed it may succeed. We all know the fly by night always manage to stay in business.

V. CONCLUSION

The foregoing discussion clearly demonstrates the onerous burden on both business and consumers that the nationwide collection of sales tax would create. The cost of gathering and maintaining the necessary information would likely drive many businesses such as mine out of the mail order business or out-of-business completely. "Business to business" mail order firms such as Priority 1 Electronics would have an even more difficult task of record keeping and compliance. The only mail order companies that could afford the cost of compliance are those few large national consumer oriented catalog houses such as Sears and J.C. Penney that are already collecting the tax because they already have a substantial retail presence in each state.

Any change in the law that would allow the states to require out-of-state merchants to collect and remit sales tax raises substantial issues of fairness and due process. If each state were then permitted to assess liability for prior years' uncollected taxes, those firms unfortunate enough to be audited would surely be driven out-of-business.

Business and consumers would not be the only losers. The federal government would lose substantial revenue from lost excise taxes, postal revenue and income taxes from mail order firms. State and local governments would likely spend more to implement and enforce a nationwide sales tax than they would collect, resulting in a net loss in revenue.

Under the various proposals now before Congress, everyone loses and nobody wins. Therefore I strongly urge you to vote against any legislation that would permit or foster a nationwide sales tax.

SECTION XIII

Sales - Use Taxes - Taxability of Specific Transactions

STATE	Maintenance Contracts	Maintenance One-Time	Replacement Parts Under Warranty Contracts	Parts & Labor Separately Stated	
Alabama	*Exempt	*Exempt	Exempt	P-T	L-E
Arizona	Taxable	*Exempt	Exempt	P-T	L-E
Arkansas	Taxable	Taxable	Exempt	P-T	L-T
California	*Exempt	*Exempt	Exempt	P-T	L-E
Colorado	Taxable	Taxable	Exempt	P-T	L-E
Connecticut	Taxable	Taxable	Exempt	P-T	L-E
District of Columbia	Taxable	Taxable	Exempt	P-T	L-T
Florida	Taxable	Taxable	Exempt	P-T	L-T
Georgia	*Exempt	*Exempt	Exempt	P-T	L-E
Hawaii	Taxable	Taxable	Exempt	P-T	L-T
Idaho	Taxable	*Exempt	Exempt	P-T	L-E
Illinois	*Exempt	*Exempt	Exempt	P-T	L-E
Indiana	*Exempt	*Exempt	Taxable	P-T	L-E
Iowa	Taxable	Taxable	Exempt	P-T	L-T
Kansas	Taxable	Taxable	Exempt	P-T	L-T
Kentucky	*Exempt	*Exempt	Exempt	P-T	L-E
Louisiana	Taxable	Taxable	Taxable	P-T	L-T
Maine	*Exempt	*Exempt	Exempt	P-T	L-E
Maryland	*Exempt	*Exempt	Exempt	P-T	L-E
Massachusetts	*Exempt	*Exempt	Exempt	P-T	L-E
Michigan	*Exempt	*Exempt	Exempt	P-T	L-E
Minnesota	*Exempt	*Exempt	Exempt	P-T	L-E
Mississippi	Taxable	Taxable	Exempt	P-T	L-T
Missouri	*Exempt	*Exempt	Exempt	P-T	L-E
Nebraska	*Exempt	*Exempt	Exempt	P-E	L-E
Nevada	*Exempt	*Exempt	Exempt	P-E	L-E
New Jersey	Taxable	Taxable	Taxable	P-T	L-T
New Mexico	Taxable	Taxable	Exempt	P-T	L-T
New York	Taxable	Taxable	Exempt	P-T	L-T
North Carolina	*Exempt	*Exempt	Taxable	P-T	L-E

Schedule D

Page 1

STATE	Maintenance Contracts	Maintenance One-Time	Replacement Parts Under Warranty Contracts	Parts & Labor Separately Stated	
North Dakota	*Exempt	*Exempt	Exempt	P-E	L-E
Ohio	*Exempt	*Exempt	Exempt	P-T	L-E
Oklahoma	*Exempt	*Exempt	Exempt	P-T	L-E
Pennsylvania	Taxable	Taxable	Exempt	P-T	L-T
Rhode Island	*Exempt	*Exempt	Taxable	P-T	L-E
South Carolina	*Exempt	*Exempt	Exempt	P-T	L-E
South Dakota	Taxable	Taxable	Exempt	P-T	L-T
Tennessee	Taxable	Taxable	Exempt	P-T	L-T
Texas	Taxable	Taxable	Exempt	P-E	L-E
Utah	Taxable	Taxable	Exempt	P-T	L-T
Vermont	Taxable	*Exempt	Exempt	P-T	L-E
Virginia	Taxable	*Exempt	Exempt	P-T	L-E
Washington	Taxable	Taxable	Taxable	P-T	L-E
West Virginia	Taxable	Taxable	Taxable	P-T	L-T
Wisconsin	Taxable	Taxable	Exempt	P-T	L-T
Wyoming	Taxable	Taxable	Exempt	P-T	L-T

*Parts taken from inventory and used for repairs on equipment covered under a maintenance contracts are deemed consumed by [redacted] and are subject to use tax.

Schedule D

Page 2

Testimony of Priority One Electronics

Exhibit 1

UNIVERSITY OF ARKANSAS
FOR MEDICAL SCIENCES

Purchase ORDER

RECTIONS

Mark all packages and freight documents with Purchase order No
and address exactly as shown in the SHIP TO instructions
Do not insure shipment at our expense unless instructed by us
PLEASE PREPAY TRANSPORTATION

P O No 50005

UAMSC supports and complies with the
Equal Employment Opportunity Act

Account Numb 021-795 Slot 554

Account Lacy

3-86

20 Tax Code T Exp Code 23900

VENDOR
Priority One Electronics
21622 Plummer St.
Chatsworth, CA 91311-9970

SHIP TO University of Arkansas for Medical Sciences
G. Richard Smith, M.D.
4301 W. Markham, Slot 554
Little Rock, AR 72205

P O # 50005 Room No Trailer 2

BILL TO:
University of Arkansas for Medical Sciences
4301 W Markham St
Little Rock, Arkansas 72205
CONTROLLER'S OFFICE
BILL itemized invoice in QUADRUPLICATE
(ORIGINAL and 3 copies)

ITEM #	QUANTITY	UNIT	DESCRIPTION OF MATERIALS OR SERVICES RENDERED (double space between items, attach list if space is inadequate)	UNIT PRICE	TOTAL
			FOB is same as ship to address unless specifically stated otherwise in your proposal		
1.	2	each	6 outlet surge and n… 08PRIACI	$29.95	$59.90
			Shipping		6.00
			Price quoted by Barr		

Distribution

WHITE VENDOR
GREEN RECEIVING ART
PINK DEPT COPY
YELLOW RECEIVING SECTION
BLUE ACCOUNTING AND AUDIT
GOLDENROD PURCHASING OFFICE
BUFF ARCHIVE FILE

Testimony of Priority One Electronics
Exhibit 2

UNIVERSITY OF ARKANSAS
FOR MEDICAL SCIENCES

Purchase ORDER

DIRECTIONS

1) Mark all packages and freight documents with Purchase order No
and address exactly as shown in the SHIP TO instructions
2) Do not insure shipment at our expense unless instructed by us
3) PLEASE PREPAY TRANSPORTATION

P O No 46048

UAMSC supports and complies with the
Equal Employment Opportunity Act

Number 320-156-900 Slot 517
Pathology

roval

5-8-86

O Code 50 Tax Code 0 Exp Code 77000

VENDOR
Priority One Electronics
21622 Plummer Street
Chatsworth, CA 91311

SHIP TO University of Arkansas for Medical Sciences
Department of Pathology Slot 517
4301 West Markham
Little Rock AR 72205

P O # 46048 Room No 4517

BILL TO:
University of Arkansas for Medical Sciences
4301 W. Markham St
Little Rock, Arkansas 72205
CONTROLLER'S OFFICE
BILL itemized invoice in QUADRUPLICATE
(ORIGINAL and 3 copies)

ITEM #	QUANTITY	UNIT	DESCRIPTION OF MATERIALS OR SERVICES RENDERED (double space between items, attach list if space is inadequate)	UNIT PRICE	TOTAL
			FOB is same as ship to address unless specifically stated otherwise in your proposal		
1	1	Each	Zipper 212A, 1200 BPS Modem Fully Hayes compatible - 2 year warranty		
			Plus Shipping		

Distribution

WHITE VENDOR
GREEN RECEIVING ART
PINK DEPT COPY
YELLOW RECEIVING SECTION
BLUE ACCOUNTING AND AUDIT
GOLDENROD PURCHASING OFFICE
BUFF ARCHIVE FILE

Carolyn C. Vinyard

Basis for Partial Shipment Only

Partial Date Rec'd ____ Amt ____ Init
Partial Date Rec'd ____ Amt ____ Init
Partial Date Rec'd ____ Amt ____ Init
Partial Date Rec'd ____ Amt ____ Init

UNIVERSITY OF ARKANSAS FOR MEDICAL SCIENCES

Purchase ORDER

P O No. 54707

DIRECTIONS

1) Mark all packages and freight documents with Purchase order No. and address exactly as shown in the SHIP TO instructions.
2) Do not insure shipment at our expense unless instructed by us.
3) PLEASE PREPAY TRANSPORTATION.

UAMSC supports and complies with the Equal Employment Opportunity Act

324-715-250 Slot 512B

Fabrica

CN91536

8-4-86

VENDOR
PRIORITY ONE
9161 Deering Avenue
Chatsworth, CA 91311
Attn: Amir

SHIP TO University of Arkansas for Medical Sciences
Department of Pediatrics Slot 512B
4301 West Markham Street
Little Rock, AR 72205
Attn: James E. Fewell, Ph.D.
P.O. # 54707 Room No. 60/16

BILL TO:
University of Arkansas for Medical Sciences
4301 W. Markham St.
Little Rock, Arkansas 72205
CONTROLLER'S OFFICE
BILL itemized invoice in QUADRUPLICATE (ORIGINAL and 3 copies).

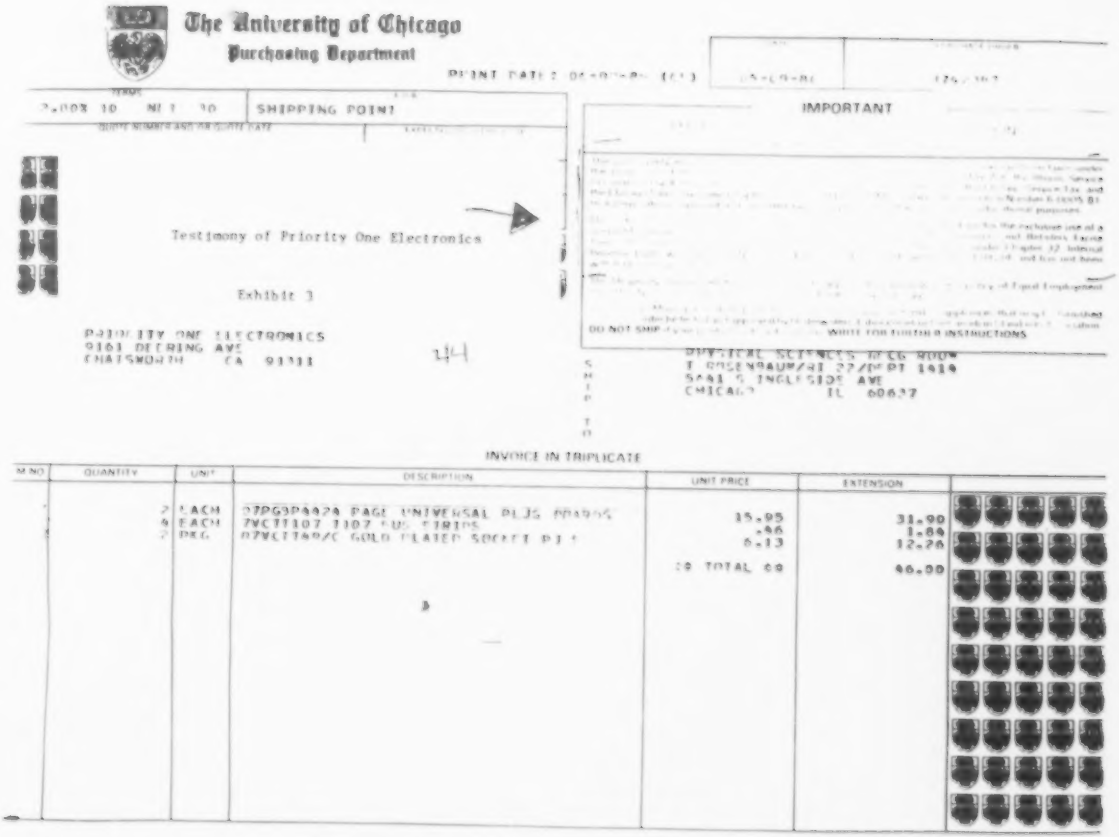
ITEM #	QUANTITY	UNIT	DESCRIPTION OF MATERIALS OR SERVICES RENDERED (double space between items; attach list if space is inadequate)	UNIT PRICE	TOTAL
			FOB is same as ship to address unless specifically stated otherwise in your proposal		
#1	1	each	MCPI 8 Channel low voltage controller board Part # 07MULIC810	215.00	215.00

Testimony of Priority One Electronics

Exhibit 2

Carolyn Patterson

DISTRIBUTION
WHITE VENDOR
GREEN RECEIVING RPT
PINK DEPT COPY
YELLOW RECEIVING SECTION
BLUE ACCOUNTING PRE AUDIT
GOLDENROD PURCHASING OFFICE
BUFF JACKET FILE



The University of Chicago
Purchasing Department

PRINT DATE: 05/07/96 (C)

SHIPPING POINT

IMPORTANT

DO NOT SHIP

WRITE FOR FURTHER INSTRUCTIONS

Testimony of Priority One Electronics

Exhibit 3

PRIORITY ONE ELECTRONICS
9161 DEERING AVE
CHATSWORTH CA 91311

PHYSICAL SCIENCES 10 CG 9000
T OSENBAUM/RM 27/DEPT 1414
5801 S INGLESIDE AVE
CHICAGO IL 60637

INVOICE IN TRIPLICATE

M NO	QUANTITY	UNIT	DESCRIPTION	UNIT PRICE	EXTENSION
	2	EACH	27PG3P4424 PAGE UNIVERSAL PLUS 6P4P5C	15.95	31.90
	6	EACH	7WC77107 3107 SUB STRIPS	.86	1.84
	2	DEC	27WC7769C GOLD PLATED SOCKET PI	6.13	12.26
				00 TOTAL 00	46.00

Testimony of Priority One Electronics

Exhibit 6

MULTIJURISDICTION

(See reverse side for instructions)

Issued to (Seller) | Address

I certify that | Name of Firm (Buyer)

Street Address or P.O. Box No.

City | State | ZIP

is engaged as a registered:
- ☐ Wholesaler
- ☐ Retailer
- ☐ Manufacturer
- ☐ Lessor (*See note on reverse side)
- ☐ Other (Specify)

and

is registered with the below listed states and cities within which your firm would deliver purchases to us and that any such purchases are for wholesale, resale, ingredients or components of a new product to be resold, leased, or rented in the normal course of our business. We are in the business of wholesaling, retailing, manufacturing, leasing (renting) the following:

Description of Business

City or State	State Registration or ID No.	City or State	State Registration or ID No.

I further certify that if any property so purchased tax free is used or consumed by the firm as to make it subject to a Sales or Use Tax we will pay the tax due direct to the proper taxing authority when state law so provides or inform the seller for added tax billing. This certificate shall be part of each order which we may hereafter give to you, unless otherwise specified, and shall be valid until canceled by us in writing or revoked by the city or state.

General description of products to be purchased from the seller

Under penalties of perjury, I swear or affirm that the information on this form is true and correct as to every material matter.

Authorized Signature (Owner, Partner or Corporate Officer)	Title	Date

INSTRUCTIONS REGARDING UNIFORM SALES & USE TAX CERTIFICATE

TO SELLERS/CUSTOMERS

In order to comply with the majority of state and local sales tax law requirements, seller must have in its files a properly executed exemption certificate from all of its customers who claim sales tax exemption. If seller does not have this certificate, it is obliged to collect the tax for the state in which the property is delivered.

If buyer is entitled to sales tax exemption, buyer should complete the certificate and send it to seller at its earliest convenience. If buyer purchases tax free for a reason for which this form does not provide, buyer should send seller its special certificate or statement.

This form of certificate has been determined to be acceptable to the following states when used in compliance with their laws:

Alabama	Maine**	Rhode Island
Alaska	Maryland	South Carolina
Arizona*	Massachusetts	South Dakota
Arkansas	Michigan	Tennessee
Colorado	Minnesota	Texas
Connecticut	Missouri	Utah
District of Columbia	Nebraska	Vermont
Georgia	Nevada	Washington
Idaho	New Mexico	Wisconsin***
Illinois**	North Dakota	West Virginia
Iowa	Oklahoma*	Wyoming
Kansas	Pennsylvania	

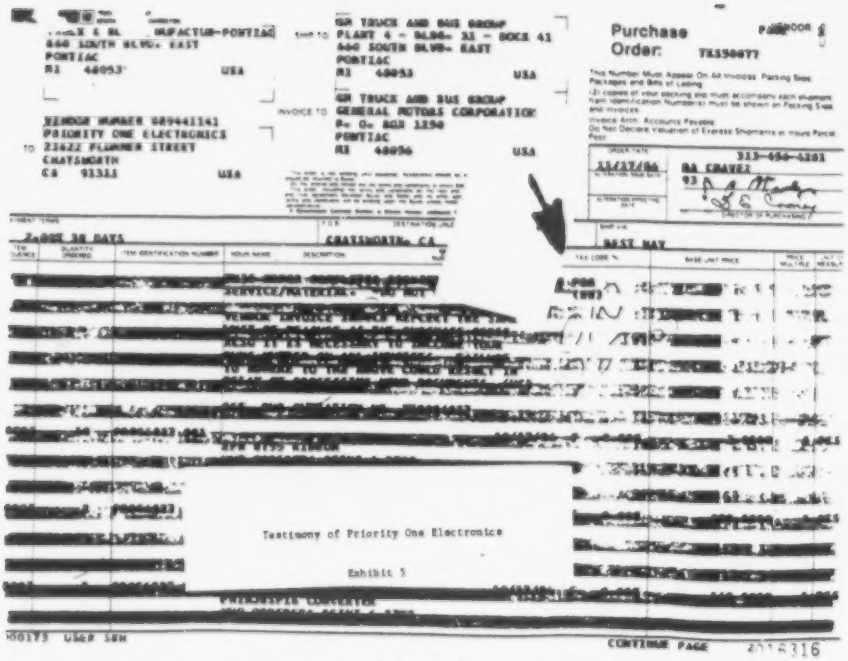
*Arizona and Oklahoma hold a seller liable for sales tax due on any sales with respect to which an exemption certificate is found to be invalid, for whatever reason.

**Illinois and Maine do not have an exemption on sales of property for subsequent lease or rental.

***Wisconsin allows this certificate to be used to claim a resale exemption only when the item will be resold in the same form. Wisconsin does not permit this certificate to be used to claim any other type of exemption.

CAUTION TO SELLER:

In order for the certificate to be accepted in good faith by seller, seller must exercise care that the property being sold is of a type normally sold wholesale, resold, leased, rented, or utilized as an ingredient or component part of a product manufactured by buyer in the usual course of its business. A seller failing to exercise due care could be held liable for the sales tax due in some states or cities. Misuse of this certificate by seller, lessor, buyer, lessee, or the representative thereof may be punishable by fine, imprisonment or loss of right to issue certificates in some states or cities.



Testimony of Priority One Electronics

Exhibit 5

SALES AND USE TAX NOTES

DEDUCTION TREATMENT
ON BAD DEBTS

Note: [redacted] files all of the Sales and Use Tax Returns on an accrual method.

STATE	Yes/No DEDUCTION ALLOWANCE	COMMENTS
Alabama	No	No deduction from tax base can be taken for losses.
Arizona	Yes	A deduction may be taken for bad debt if the income was originally reported as taxable for the month in which the sale took place.
Arkansas	Yes	Taxpayers may deduct bad debts from the total amount upon which the tax is calculated for any report.
California	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
Connecticut	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
District of Columbia	No	Losses generally, are not deductible
Florida	Yes	Allowed if charged off for Federal income tax purposes.
Georgia	Yes	Deductible if tax previously paid on an accrual basis and charged off for income tax purposes.
Hawaii	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
Idaho	Yes	Accounts found worthless and charged off for income tax purposes are deductible.

Schedule K

STATE	Yes/No DEDUCTION ALLOWANCE	COMMENTS
Illinois	Yes	Refunds deductible if tax previously paid on accrual basis.
Indiana	Yes	Allowed if charged off for Federal income tax purposes.
Iowa	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
Kansas	Yes	Refunds deductible if tax previously paid on accrual basis.
Kentucky	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
Louisiana	Yes	Allowed if charged off for Fed income tax purposes.
Maine	Yes	Deduction may be taken if actually written off books.
Maryland	Refund	Taxes paid on accrual basis that seller cannot collect are refundable if claim is presented to Comptroller within 3 years of payment.
Massachusetts	No	Losses, generally , are not deductible.
Michigan	Yes	Deductible if written off books.
Minnesota	Yes	Tax credit is in ratio of debt uncollectible in tax year to total debt from the transaction.
Mississippi	Yes	Allowed only when sales tax is paid on an accrual basis.
Missouri	Yes	Accounts found worthless and charged off off for income tax purposes.
Nebraska	Yes	Deductible if written off books.
Nevada	No	There is no permission to take a deduction for bad debts.

Schedule K

STATE	Yes/No DEDUCTION ALLOWANCE	COMMENTS
New Jersey	Refund	Vendors can't deduct from gross receipts bad debts. Instead, they must file for a refund of the overpayment of tax.
New Mexico	Yes	Deductible if actually written off books.
New York	Yes	Deductible if written off books.
North Carolina	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
North Dakota	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
Ohio	Yes	Deductible if tax previously paid and debt uncollectible, except repossessed property.
Oklahoma	Yes	If seller has paid tax, he may claim credit on subsequent return, if written off for income tax purposes.
Rhode Island	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
South Carolina	No	Deduction on account of losses are not allowed.
South Dakota	Yes	Credits for sales taxes paid on worthless accounts must be taken on the next sales tax return filed following the federal income tax return which the bad debts are charged off.
Tennessee	Yes	Allowed if charged off for federal income tax.
Texas	Yes	Allowed if charged off for federal income tax.
Utah	Yes	Accounts found worthless and charged off for income tax purposes are deductible. However, the seller must establish by records or other means that he has not been reimbursed.

Schedule K

STATE	Yes/No DEDUCTION ALLOWANCE	COMMENTS
Vermont	Yes	Deductible if written off.
Virginia	Yes	Deductible if written off.
Washington	Yes	Allowed if deducted on income tax return.
Washington B. & O. Tax	No	Losses are not deductible.
West Virginia	No	Losses are not deductible.
W.V. Gross Receipts Tax	Yes	Retailers who file on an accrual basis may deduct uncollected debts from their Gross receipts tax.
Wisconsin	Yes	Accounts found worthless and charged off for income tax purposes are deductible.
Wyoming	Yes	Sellers who can't recover payments from accounts on which tax has been paid can duduct the uncollectible amounts from their gross receipts. Seller must certify that they have determined such accounts to be totally worthless and uncollectible.

Schedule K

Mr. DORGAN. Thank you very much, Mr. Kline.

Now, I discern that the panel members on this panel are not real excited about this legislation.

Mr. FISHER. We are, just not in the same direction.

Mr. DORGAN. All right, we will strike that and just say there is excitement, but a different kind of excitement than one might hope.

Let me ask some questions, let me start, Mr. Kline, with you, since you have finished. I guess the question I have is, is it really going to put you out of business? If so, obviously I am concerned, but when you say that a requirement that we would impose to ask your company to collect the sales tax or use tax when marketing puts your company out of business, and I say why would that happen? What sort of enormous complications are we posing for you and what kind of requirements are we imposing upon you that would put you out of business.

Mr. KLINE. Well, it was mentioned earlier today that there were computer programs that were available to simply tell us whether or not an item was taxable. The realities is they that do not exist. If we had to invest the time and money in the order processing loop, looking at each order for taxable line items. Take for example spare parts as just one small part of the items that we sell. We would have to test each line item 32 different ways for each State, we could not take that burden on the front end; and then if we made a mistake, that mistake is multiplied.

The way the States conduct a sales tax audit is they use statistical samples, they come, they look at a couple days' invoices, take whatever error rate they find and multiply it out for the audit period. As I mentioned, a $12 mistake cost me $10,000. If they found a $20 mistake, it would just wipe me out.

Now, the people here selling consumer goods talk about a 5 percent aftertax profit. I would love to have a pretax profit of that. My margin for the last 10 years that I have been in business averages less than 1 percent. There is no way that two States could come in and subject me to this type of thing and still survive.

Mr. DORGAN. I am concerned about that because, you know, the point has been made here today that Sears Roebuck, for example, has a catalog operation, they sell across the country and collect the local tax. Someone said, that is different because they are bigger, they have regional distribution centers. I understand there is a difference in that respect, but I have two questions with respect to that. Perhaps, Mr. Glazer, I could address this to you.

Do we have experience on what the cost of collection of the tax is for those who do collect the tax, such as Sears and others? Is it the 15 percent that you are describing, or is it less than that? Does anybody know?

Mr. GLAZER. There was a study done by Touche Ross, but I am not sure that Sears and Penneys cooperated in that study. One of the points made in the Touche Ross study was that on average it costs 15 cents for every dollar collected, and it was pointed out that as companies got larger or were larger, the relative cost of administering the tax burden would diminish. Therefore I would assume that a Sears, Roebuck would have a cost that is far below 15 cents per dollar collected but, on the other hand, for smaller companies

the cost might be far in excess of 15 cents per dollar collected. I think that is the best answer.

As it relates to Sears, Roebuck, the vast majority of their sales are made over telephone numbers and then the merchandise is shipped to the local store whereby the customer then goes to the store and picks up the merchandise. The transaction is not done through the mail by and large. In fact, as I have looked at the rather large Sears catalog as opposed to the smaller specialty ones, I am not sure that they even have an order form in there that the customer could mail in an order. It is expected that they are going to go to the store and pay the tax at the store.

Additionally, some of the very largest retailers, such as Sears, offer their own in-house charge card, and the overwhelming majority of these sales are automatically given to the charge card and the retailer then adds the sales tax. If the customer wants to ever do a second purchase with Sears, they had better pay for the last purchase, including the sales tax.

There are very few direct marketing companies of moderate size, I probably would say none of moderate size that have an in-house credit operation and who rely predominantly on credit sales.

Mr. DORGAN. I think we will want to get some information from those who are involved in direct sales who do collect the sales tax to try and get some idea of what the cost of the collection is, because your representation is a question that we really need to try and clear up.

Mr. Kline, if instead of five retail outlets you have only one in California and no mail operations, but I had a mail operation selling exactly what you sell, but I did not have to charge the California consumption tax and you did, would that concern you?

Mr. KLINE. No, it does not. I face that very situation every day. Mail order is the smallest part of our business. The retail is what is growing for us and we compete, if you will, against out-of-State merchants all the time. But by the time you add the shipping and handling, especially in our case since the product is so expensive and so delicate, by the time you take a premium carrier and add the insurance to it, you can walk out our front door of our retail store and end up spending less money for that item than having it shipped out our back door. So I do not have any problem in competing with mail order firms.

Mr. DORGAN. Mr. End, are there any conditions under which L.L. Bean would agree to collect local consumption taxes or do you feel that they are just too onerous?

Mr. END. Well, clearly if this legislation or any legislation like it is passed, we would comply fully with the letter and the intent of the law. I think the key issue we are broaching here is the complexity of this and the burden being put on the mail order companies.

I think the point raised earlier by Alan was that 15 cents of every tax dollar raised is the administrative cost for mail order companies; comparable retail stores, it has been estimated only uses 2.5 cents for that same collection cost, so the burden is roughly six times greater on a mail order company.

And just to again reiterate where that difference comes, Sears does collect sales tax in all States but they also devote two entire

pages of their catalog to trying to explain how one goes about completing that in all those jurisdictions. For us to do the same thing, two pages in each of our 21 catalogs would cost $950,000 a year. In addition, we would have to chase all of those people who did not make payment, and we would have a substantial administration cost of several hundred thousand dollars just due to that collection effort, and if as few as 5 percent of them did not make payment, the costs there would be something in excess of $600,000 a year.

Mr. DORGAN. But is that not something every retailer faces? I owned a retail business and I did not happen to sell automobiles. But if I sold automobiles and someone said to me, all right, $4,000, but that has to include the excise tax, you are confronted with the question of do you eat the excise tax or do you insist that it be above and move the sale.

If someone comes in and charges, you include the sales tax in the charge and they do not pay the charge—I am wondering whether this is not a common business problem.

Mr. END. I think it is quite different. I think in the case of a retailer you are basically looking at making that collection effort at the point of sale and you basically do not turn over ownership of the goods until the payment is made, including the sales tax. We are not talking here about finance charges or financing the goods and any loss that later might occur.

What we are doing in this case is we are collecting the revenue for someone else, another State, this is money that L.L. Bean does not owe, this is money that the customer owes, and I see a major distinction in that case. We take on a liability here, an administrative effort here for which we get no return.

I think a point was raised earlier today about the question of whether or not the States would be willing to reimburse us for the differential in those administrative costs. If it costs us 15 cents on the dollar and a retailer 2.5 cents on the dollar and we were reimbursed correspondingly, I certainly would have no objection to that.

Mr. DORGAN. If I have a mail order catalog company and I decide I am in two States now, the question is shall I go into the third State. The question is should I not be required to analyze what is the cost of doing that, including the total cost of doing business in that State, which includes the cost of collecting the consumption tax?

The main street business person would argue that you ought to make that judgment of whether you enter that third State based on all the costs of doing business in the State that they incur, how do you react to that?

Mr. END. Well, I think that is a reasonable question. I think if L.L. Bean chose to open a retail store in the State of Massachusetts, that is a very straight-forward business decision. Do we get enough incremental demand from opening that store to offset whatever else occurs for the burden of collecting sales tax on all of our mail order business in that State?

I think because an awful lot of people will buy only through retail stores, I think there are oftentimes good arguments for making that move into the other State. I think a lot of companies have done so.

Mr. DORGAN. When I asked about doing business, I am not just talking about opening a store. I happen to feel that if you make a decision that we are going to go into North Dakota with catalogs and regularly solicit with catalogs, I think we are doing business in North Dakota. Of course, that is the whole question of nexus.

Mr. END. Right.

Mr. DORGAN. But I am saying when you make that decision to enter that marketplace, you have nexus. I think Mr. Fisher made the point that we really have no relationship with that State. I think I have a disagreement with that statement. Do you not have a relationship with a group of 10,000 consumers in South Dakota, for example, or Nebraska?

Mr. FISHER. Certainly.

Mr. DORGAN. Does that relationship not persuade you, when you decide to take advantage of that market and establish a business relationship with those consumers, to comply with whatever exists for a local merchant to comply with in doing business?

Mr. FISHER. I am a bit confused, Mr. Dorgan. We have a relationship with the customers, not with the State. The State has not allowed us to go in there. This is a matter of we advertise by mail and they chose—the citizens, our customers chose to buy. The State of North Dakota or the State of Nebraska did not reply and say we want a piece of the action because we are letting you sell to our customers.

Now, the local main street merchant to whom you refer in North Dakota is getting, as we have heard many times today, services from your State, not to mention the local identification and presence. The reason that some of these newer combined retail direct marketing operations are burgeoning—and, by the way, paying a lot of sales tax already—Sharper Image, Banana Republic, Brookstone, as Mr. Glazer mentioned, and a number of others—is that the combination of the local presence stimulating the marketing and the ability to be there and benefit from it is a different situation than solely going in on the mail.

Our relationship is not with the State, it is with the residents of the State, and I do not see how the State facilitates that.

Mr. DORGAN. Well, I don't agree with it, but I understand the point you are making. I cannot escape this evening when I go home and turn the television set on and run through all the dials, the Home Shopping Club. I do not enjoy the "toots", but the channels are going to turn and I am going to hear the horn being tooted, selling more porcelain dolls or something. Bless them, I think it is a service, I think the customer ought to be offered every opportunity to purchase in any way possible in this country.

My guess is that television direct marketing is going to be with us for a long time and I think it is probably going to explode in this country. The question is, if I sit there and watch that tonight and decide to buy something, why should I not pay the appropriate Virginia consumption tax? I guess my own feeling is I probably should.

Mr. FISHER. Well, if I were the Virginia revenue person I would agree with you, and then it would seem to me the sensible approach would be the Virginian should seek the money from the Virginian and leave the Minnesota company out of this.

Mr. DORGAN. The point that Mr. Keating made, which I found interesting, coming from the National Taxpayers Union, which advocates generally less government, is that States really ought to gear up to collect the use tax. If you want to talk about building an American bureaucracy, just try and get enough men and women together to enforce a use tax. You are talking about an army of people and then you will not get it done. From a practical standpoint, Mr. Keating, that is absolutely impractical and impossible.

Mr. FISHER. Well, then that brings us back to the point that Mr. End discussed, which is we have heard testimony this morning to the effect that even if our collection costs are higher—and I think it is easily demonstrable that for the smaller business they are substantially higher—there was no real interest in compensating for those higher costs and thereby in effect taxing our businesses and not the residents of the State or not solely the residents of the State.

Mr. GLAZER. I think, by the way, that you made a point, sir, a bit earlier when you suggest that if the States would attempt by the mail, telephone or whatever to collect the tax from their own consumers, there would be an incredibly large bureaucracy, one which the States would not be able to undertake.

In effect, you are delegating bureaucracy to the catalog companies and direct marketers. You are saying we, the tax revenue people, cannot collect it through the mail, why do you not collect it and send it along to us and why do you not incur that cost. I think that we could sit here and debate the theory of the justification of a company located in New York collecting a tax from a consumer in North Dakota, but at some point I think you have to draw the distinction between the theory and the philosophy and the practicality of so doing.

Mr. DORGAN. Mr. Glazer, you understand perfectly well, why we have a sales tax collection requirement on merchants, because it is easier to collect water at the shower spigot up there than it is in the bottom of the bathtub. We attempt to go back as far as we can in the chain and ask someone to bear the responsibility of collecting the tax.

I made the point earlier that the tax is really on the consumer. The retailer in most States is required by law to collect it, and the reason that you cannot practically collect the use tax is there is not any way you can administer either a sales or a use tax on millions of different transactions. Instead, what you do is you have the retailer be the point of collection of the tax.

I will let Mr. Vander Jagt inquire, please.

Mr. VANDER JAGT. Thank you very much, Mr. Chairman. I thank each member of the panel for your contribution and for some of the hands-on, on-the-scene experience that you can bring to the attention of this Committee.

Does any member of the panel have any suggestions? I do not think anybody maintains that there is any authority to tax an out-of-State wholesaler for a sale made in another State. I do not think anybody takes that position. What people are trying to do is impose the tax collecting responsibility on the out-of-state wholesaler.

If there were any way to collect the tax from the State resident, that the State resident owes that State, perhaps the whole problem

would be solved. Does anybody have any suggestion as to how that might be done?

Mr. KLINE. About the only thing that would make any sense to me, is something that has been debated up here before, it would be a national value added tax, that would wipe out every State tax, every local tax, and have one uniform tax. As we have heard today, everyone wants an equal playing field. That would be the only way to achieve it. But with so many exemptions—for example, in my case, some universities in some States are taxable and other universities are not in other States. It is just an absolute impossible burden.

So unless it was absolutely level, it could not be done.

Mr. VANDER JAGT. I thought Mr. Glazer made an interesting point, where the States would have to set up this enormous bureaucracy to do it, so the suggestion is that you set up the machinery and bear the cost of it. I do not know if any of you were here when I asked Governor Thompson, representing the Governors' Association, if there would be any willingness to reimburse you for your costs of collection, which I think are demonstrably much higher than a retailer who just rings it up on the cash register. I did not get much enthusiasm in his response.

If you could be reimbursed for the additional cost, would that make this method of collecting the tax acceptable?

Mr. END. I think we all recognize that the tax is owed by the consumer and I think anything that could be done in the legislation to simplify, making the administrative burdens less, trying to come up with a common, single rate, if that were possible, anything in legislation if it does go forward that would simplify that bureaucratic process would certainly make all our lives much, much easier.

Mr. VANDER JAGT. I have one last question, Mr. Chairman. I know the bells have rung for the second time and our panel has been so patient that I do not want to ask them to stay any longer.

I do not know if there has been any testimony on this when I have not been here, but part of the bill would require the national wholesaler to file with his Federal income tax return with IRS a national sales sheet and then IRS would make it available to each of the States. Do any of you have any wisdom to shed on what kind of additional burden that might place on the IRS?

Mr. GLAZER. I would like to make a comment on that, if I may, on that subject. Approximately a year ago I had the privilege to testify before a Senate subcommittee on a similar piece of legislation, and at that time it was indicated that there would be no problem, certainly a computer could reconcile this entire thing, it would have the software package available and therefore it would tell you the direct marketer just how much is owed to each State.

I have dealt with computers for a number of years and I know that they are not necessarily all they are cracked up to be. It was quite prophetic though on that day when I returned home from Washington and in my mail was a letter from the Internal Revenue Service which said, "Mr. and Mrs. Glazer, we have misplaced your 1983 tax return papers, please photocopy all your papers and send them to us. If you do not, you will be subject to penalties."

I sat there and I said to myself we are being told that the computer will do it all, will solve the problem and all you have to do is write 45 checks, one to each State, and your problems will be over, and here is the Federal Government, with far greater resources for computerization and they cannot find my tax return. Fortunately, I had kept photocopies and sent it along. What was ironic is I knew where my return was for 1983.

Mr. VANDER JAGT. Thank you very much, and thank you all for your contributions.

Mr. DORGAN. Let me just point out that the exception does not always demonstrate the rule, Mr. Glazer. I understand exactly what you are saying. I have had the government lose records of mine as well. We deal with billions of pieces of information in the private and public sector and my guess is you will understand in your business and in the Federal Government that most of the records are dealt with appropriately.

Notwithstanding that, let me just say this: I think I have a disagreement with the testimony of the panel, but I think the panel has set up in very logical form your objections to the legislation. If we move ahead with this type of legislation I think we will find the testimony that you have given us very useful in analyzing what we ought to be concerned about and what we ought to be aware of with respect to your firms.

For that reason, your appearance here is important to us and I especially want to say I appreciate your willingness to be patient today and spend the time with us up until 3 o'clock.

With that, if there are no further comments from the panel, the subcommittee will stand adjourned.

[Whereupon, at 3:12 p.m., the subcommittee was adjourned.]

[Submissions for the record follow:]

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Testimony
Before the
Subcommittee on Select Revenue Measures
Committee on Ways and Means
United States House of Representatives
May 13, 1987

The American Association of Nurserymen welcomes this opportunity to present the views of the nursery industry with respect to H.R.1242--the "Interstate Sales Tax Collection Act of 1987." This testimony is also presented on behalf of the Mailorder Association of Nurserymen.

The American Association of Nurserymen (AAN) is the national trade association of the nursery, landscape, garden center and mailorder industry. We represent nearly 4,000 firms across the country engaged in all aspects of the green plant industry -- its grower, landscape, retail and direct mail segments. By almost any standard, our members are primarily small family-owned farms and businesses. It is estimated that the retail value strictly of nursery crops sold in the United States in 1985 was $5.82 billion.

Mr. Chairman, AAN vigorously opposes H.R.1242 on the grounds that such legislation would be impractical to implement, and even if it could, it would quickly prove exceedingly burdensome to companies engaged (in whole or in part) in mailorder sales. As if these reasons are insufficient, it can be convincingly argued that, even on its face, H.R.1242 is unconstitutional.

H.R.1242 would authorize states and local governments to require retailers to collect sales and use taxes on interstate sales. This bill would also amend the tax code to require that such retailers file information returns with the Internal Revenue Service to assist the states in collecting such taxes. Currently, a state or local government may impose taxes on sales occurring within its jurisdiction. However, there are obvious limitations on the methods by which state and local jurisdictions may collect such taxes. Although, state and

local sales taxes are levied on the final purchaser of goods, they are collected primarily through the vendor.

In 1967, the United States Supreme Court ruled in National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois that state or local governments cannot constitutionally require a retail vendor to collect and remit those taxes unless the vendor has a sufficient business nexus within that state. In this case, the Supreme Court found that the required nexus was not present because a retail vendor's only connection with customers in the state was by common carriers via the postal system.

This landmark decision was based in part on the fairness principle embodied in the due process clause of the United States Constitution. The Supreme Court found that the simple and controlling question is whether a state has given anything for which it can ask in return. Neither a mailorder company nor its out-of-state customers derive any benefits from out-of state services. Businesses with no presence in a state have no political voices there and cannot depend upon ordinary democratic protections. Therefore, it is not difficult to understand that under such circumstances, the Supreme Court ruled it would be wholly unfair to impose tax-collecting duties upon out-of-state mailorder retailers.

Simply stated, H.R.1242 overturns this Supreme Court decision which has stood for twenty years. Of course, it is the perogative of the Congress to seek legislative remedies for judicial decisions with which it may disagree for political reasons. However, even setting aside the powerfully convincing constitutionality of this issue, the Supreme Court decision makes eminent and cogent common sense.

As stated earlier, the collection and compliance costs to a retailer will likely be heavy and burdensome. Although such figures are not available to us, we question whether the amount of revenue, which the states (and political subdivisions thereof) stand to accrue, will outweigh the difficulties with collection which we foresee as

absolutely inevitable under H.R.1242. Presently, we understand that 46 states have applicable sales or use taxes. A salient question which Members of this Subcommittee should carefully consider is how retailers with interstate sales will be able to keep track of each state's tax rate. Just think how much more extraordinarily difficult it will be for mailorder companies to cope with as many as 46 different tax laws than it is for a retail store to cope with a single sales-tax law. Some may say this is an appropriate price to pay for the so-called "privilege" of conducting business on an interstate basis. However, this is the United States where free-market private enterprise is the proven pillar of this country's economic strength and vitality.

Aside from the different tax rates, states also maintain sets of exemptions which are often amended yearly. To give you an idea as to how confusing this may become, most states exempt sales of fruit trees to commercial orchardists, while a few states tax such sales. A number of states exempt sales of food-producing plants to individual gardeners. Retailers with interstate sales will be required to have a working and, more importantly, current knowledge of the full tax laws in all states. On its surface, this will pose tremendous hardships short of maintaining a bevy of tax experts on the staff of each and every mailorder company to keep abreast of the tax rates and exemptions. When one adds the cost of matching these changing rates and exemptions against a product line, and then communicating specific instructions to customers in every state, this burden becomes excessive. Catalogues and mailings will constantly need to be altered so as to inform customers of their tax obligations.

On top of all of this, most taxes on mailorder purchases are computed by the customers. Errors, underpayments and failures to pay will become an increasingly serious problem for mailorder companies. In fact, it is not too difficult to conceive that this problem may become "nightmarish" with respect to accounting systems and practices, thereby even further exacerbating a firm's compliance costs.

It is clear that the authors of H.R.1242 recognize the difficulties this legislation will pose for many small businesses

as the bill proposes to exempt retailers whose annual nationwide gross sales are less than $5 million. AAN appreciates this sensitivity to the concerns of small business, but section 2(f) does not ameliorate the collection and compliance burden on those retailers whose annual nationwide gross sales border closely upon the $5 million threshold. In such cases, actual sales volume may not be known until year-end. What does a retailer who has collected state taxes do with such monies if at year-end the company learns it has not exceeded the $5 million sales threshold? Is the money returned to the customers? Is it distributed to the states anyway? The point here is that mailorder companies whose nationwide sales volume fluctuates from year to year, but do not know with any certainty until year-end whether they have exceeded the $5 million threshold, will be forced to collect the required taxes simply in anticipation as a means of "insurance" for themselves. Obviously, this undermines the intention of section 2(f).

On a separate, but related note, we believe the $5 million threshold is too artificially low to satisfy the concerns of truly small businesses. Moreover, we are well aware that irrespective of the size of any possible threshold which this Subcommittee may see fit to adopt, nothing now can prevent actions by future Congresses to lower that threshold. Such prospects are a legitimate concern shared by many small business firms opposed to H.R.1242.

In conclusion, Mr. Chairman, the American Association of Nurserymen and the Mailorder Association of Nurserymen strongly oppose H.R.1242. We urge the Members of this Subcommittee to carefully consider the many important points raised herein. We believe they represent the practical impediments to any implemention of H.R.1242. Lastly, and most importantly, we urge the Members of this Subcommittee not to overturn the twenty-year old decision of the United States Supreme Court which has already examined the practicality, fairness and constitutionality of this very important issue.

Thank you.

AARP

May 26, 1987

The Honorable Charles Rangel
Chairman
Subcommittee on Select Revenue Measures
Committee on Ways and Means
Washington, DC 20515

Dear Representative Rangel:

The American Association of Retired Persons, representing the interests of over 25 million older persons age 50 and over, is concerned with the negative impact that H.R. 1242, the Interstate Sales Tax Collection Act of 1987, may have on consumers.

The proposed legislation would require retailers to collect sales and use taxes on sales made to out-of-state purchasers. Aside from potential Constitutional questions involved, the legislation would be harmful to consumers in several ways.

The burden of the additional sales tax on purchases would be particularly harmful to those most dependent on mail-order purchases. The very old, the home-bound, the handicapped, and those in rural areas are prime users of mail order purchases. For these disadvantaged groups, there is often no practical alternative. Mail order purchases help these individuals maintain a dignified independent lifestyle. Without this option, many would be forced to endure hardship or inconvenience merely to secure items of necessity. These consumers are among those least able to afford the additional burden that an increased sales tax collection would bring.

The additional tax passed on to the consumer -a sales tax- is one of the more regressive forms of taxation. As a flat tax on purchased items, there is no element of progressivity in this type of tax. The lower income consumer, who must spend all or a large portion of his income, is hit hardest by a tax based on consumption. The Treasury Department, in its tax reform proposals, noted this proposition, stating "The tax would be regressive because the percentage of income used for consumption purposes declines, on the average, as income increases." The fact that the Tax Reform Act of 1986 eliminated the deduction for state and local sales taxes can no doubt be traced in part to the belief that this tax is the most regressive, and therefore should be discouraged, not subsidized. This regressivity is compounded by the fact that those most affected by this legislation will be those groups most dependent on mail-order services - the very old, the handicapped and the home-bound.

In addition to the direct tax increase borne by the consumer, the collection burden placed on the out-of-state seller would also ultimately work to the disadvantage of the consumer. The administrative difficulty of tracking 50 potentially different state laws, and the various rates and exemptions of each state's sales tax, will eventually be passed on to the consumer in the form of higher prices. Worse yet, for many sellers, the administrative collection and remittance will be crippling, and many small mail-order firms that can offer services based on current requirements may no longer be able to meet consumer needs. High compliance costs will no doubt force many mail-order firms to fold or sharply limit the available services. The reduction in competition will ultimately lead to higher prices for the consumer, and the elimination of many small or low-cost sellers will eventually lead to even fewer available products.

In short, this proposed legislation would undermine part of the value that mail-order vendors add to the marketplace. The result would be higher prices and less services, with the greatest impact falling on those most dependent on these services--the elderly, the home-bound, the handicapped, and those in rural areas--and those least able to afford the additional burden.

AARP thus believes that the problems associated with the proposed changes far outweigh the anticipated benefits. AARP therefore urges maintenance of the existing standards, and recommends no action be taken to alter the current standards.

Sincerely,

John Rother
Director
Division of Legislation, Research
and Public Policy

aap

Association of American Publishers, Inc.

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Statement of the Association of American Publishers, Inc.
Before
The Select Revenue Subcommittee
of the
Committee on Ways and Means of the House of Representatives
With Respect to HR 1242 and Similar Measures

The Association of American Publishers, Inc. ("AAP") respectfully urges the defeat of HR 1242 and similar bills which would authorize state and local entities to impose and collect sales and use tax on interstate sales transactions.

The AAP is the major national trade organization representing the book publishing industry in the United States. Our membership is estimated to produce more than 80 percent of the total number of books sold in this country each year. Our members include very large publishers which may issue hundreds or even thousands of new titles each year, small, highly specialized publishers of scholarly works who may issue only a few new titles annually, and university, non-profit and religious presses. A substantial majority of book sales in the United States occur at retail (through book stores and similar outlets) and these transactions would not be affected by HR 1242. But, a significant -- and critically important -- percentage of books are sold on a direct-to-consumer basis. This includes not only direct market and book clubs' books, but also transactions involving scholarly and special interest books which are not typically stocked by conventional retail outlets. In fiscal 1986, over 150,000,000 book shipments were delivered directly to consumers via the United States Postal Service, and it is estimated that a comparable number of book packages reached the intended ultimate consumer via the facilities of the United Parcel Service. It is the harm that would befall these interstate direct sale of books and the social effects of that harm which has led the AAP to oppose HR 1242 and similar measures.

In testimony presented to the committee, others have documented the deleterious effects to direct marketers which would ensue from the passage of HR 1242. We share those concerns. We are particularly alarmed by the fact that the cost of collection of an interstate sales or use tax falls disproportionately upon smaller marketers. As applied to our industry, this means that the burden of tax collection will fall hardest upon publishers of professional and scholarly works because these publishers tend to be small in size and rely significantly upon direct to consumer sales. Nor is there merit to the claims that the passage of HR 1242 would equalize the competitive balance between local stores and interstate marketers. What these claims ignore are the reasons for sales or use tax and the social reasons which have given rise to and have sustained the growth of interstate direct marketing. Plainly, an out-of-state marketer does not burden local police, safety and social services in the same way, or to the same extent, as a local retail store; yet, under HR 1242 the responsibility for collection of the tax as between the two merchants is the same and the burden of collection is disproportionately greater upon the out-of-state marketer. Moreover, the claim that local stores are unfairly disadvantaged presupposes that the consumer has a perfect and equal choice in satisfying his needs and wants as between the so-called Main Street shop and buying by mail. In the real world, however, that perfect choice does not exist. Even in our largest metropolitan centers, bookstores are relatively few and far between. In smaller cities and towns and in rural areas, bookstores are indeed scarce. And, in all markets no bookstore can or could realistically be expected to carry the full array of titles and types of books which American publishers produce. In publishing (and other industries) consumers resort to direct marketing precisely because the products they want, need and are entitled to have are not otherwise available to them. It seems to us peculiar, if not downright unfair, to insist,

as HR 1242 proposes, that consumers who buy by mail must pay state and local sales and use tax in order to preserve and protect local retail outlets which have not and cannot satisfy those consumers' needs and interests.

In the case of our industry, there is a larger and even more fundamental social policy which has been overlooked in the debate over this Bill. It has long been the fundamental policy of the Congress to encourage and promote the dissemination of books and other educational materials as a part of the First Amendment goal of an informed and educated citizenry, upon which our system of government is critically dependent. That Congressional policy has been expressed in a variety of legislative measures, the most relevant of which, for present purposes, are those dealing with the Postal Service. In 1928, the Congress created a special reduced postal rate category for books and other educational materials shipped to schools, colleges, universities and libraries. Ten years later, a separate category -- the Special Rate Fourth Class category -- was created specifically to permit the distribution of books and other educational materials direct to consumers at reduced rates.

Congress reaffirmed these policies in the Postal Reorganization Act of 1970. Congress mandated that the special rate categories for books and other educational materials be preserved. It further decreed that the rates for these special materials must be uniform regardless of distance in order to assure that consumers in remote areas would not pay a higher price for these materials than consumers living in the urbanized areas close to publishing centers. For a period of years after postal reorganization, both the rate governing shipments direct to the consumer and the library rate were subsidized by federal appropriations. The library rate remains subsidized; and the Congress has expressly required those who set rates for the Postal Service to reduce Special Rate Fourth Class rates in order to reflect the "educational, cultural, scientific and informational value" of these materials to the recipients.

We find it difficult to reconcile the expressions of Congressional policy underlying these postal laws with the intent of HR 1242. The former seeks to promote and encourage the dissemination of books and educational materials, via interstate sales, at the lowest possible cost to the consumers; the latter, by permitting the imposition of state and local sales and use tax, will inevitably increase the cost of interstate sale of books and other educational materials to consumers. The conflict in policies is particularly ironic because both the existing postal legislation and the proposed interstate direct marketing sales and use tax measures focus on precisely the same type of transaction -- the interstate dissemination of books and other educational materials -- but treat them in diametrically opposite ways. Viewed in this context, the controversy surrounding HR 1242 and similar measures involves more than merely the question whether state and local sales and use tax should be imposed upon interstate transactions in order to satisfy the fiscal needs of some states and the competitive concerns of some retailers. Rather, the question is whether Congress intends to adhere to its long-standing policy of supporting and promoting the dissemination of books and other educational materials or whether, for the first time, Congress intends to sanction what amounts to a tax upon information and knowledge.

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ERNEST J. DRONENBURG, JR.
MEMBER, STATE BOARD OF EQUALIZATION

STATEMENT OF
ERNEST J. DRONENBURG, JR.
VICE CHAIRMAN
CALIFORNIA STATE BOARD OF EQUALIZATION
ON
H.R. 1242
THE INTERSTATE SALES TAX COLLECTION ACT OF 1987

Mr. Chairman and distinguished Members of the Subcommittee, I am pleased to offer this statement on behalf of the California State Board of Equalization, the agency charged with the administration of California's Sales and Use Tax laws.

The Board strongly supports H.R. 1242, the "Interstate Sales Tax Collection Act of 1987" as the best means of restoring an equality to the healthy competition between domestic and out-of-state mail-order business that has been in an increasingly imbalanced state since the Supreme Court's 1967 decision in National Bellas Hess v. Illinois Department of Revenue.

As the Subcommittee is aware, in that landmark case the Court held that mail-order retailers outside of a State's borders could not be compelled to collect sales or use taxes on sales to that State's residents unless a sufficient "nexus" existed between the State and that company.

It is also important to note what the Court did not say. It did not say that a State could never impose the burdens of collecting such taxes upon interstate sales. Rather, the decision turned on the facts of what constituted a nexus -- "some definite link, some minimum connection, between a state and the person or property or transaction it seeks to tax" -- that was sufficient to withstand constitutional challenges under both the Due Process and Commerce Clauses of the Constitution.

I raise this issue at the outset because you are very likely to hear arguments that, in deciding upon the adequacy of this nexus, the Court based its decision on one, or the other, or both of these constitutional grounds.

The arguments on all sides are fascinating. Nonetheless, I believe it is clear that Congress has the power, in the words of Mr. Justice Douglas, "to grant protection to interstate commerce against state regulation or taxation or to withhold it" (emphasis added).

We therefore encourage the Committee to maintain its focus on that which is clearly within its power, and not permit the intricacies of legal supposition to cloud the critical issue that this legislation addresses: local retailers cannot compete on a fair basis with mail-order retailers. In the words of the National Bellas Hess decision, "Congress alone has the power of regulation and control" in this area, and we urge you to use that power to restore a competitive balance.

There is a clear and compelling need for such Congressional action. I believe that this will become apparent as you consider the facts as they exist today, 20 years after National Bellas Hess was decided.

First and perhaps foremost, it is important to recognize the technological changes that have occurred, because these directly affect the critical issue of nexus. For example, consider the mail-order retailer's ever-expanding use of targeted television and radio advertising, toll-free 800 telephone numbers for ordering, and payment by using credit cards issued by in-state banks.

These advances have given the mail-order business a presence within a given State's consumer market which rivals that of the local merchant. We believe that this 1987 presence, to which the local retailer surely can attest, meets the definition of a "definite link" or "minimum connection" for the purposes of permitting State taxation of interstate sales.

Furthermore, how can a mail-order business that uses California's television facilities and newspapers for its advertisements, California's telecommunications facilities for its toll-free numbers, California's banking facilities for its customers' credit card purchases, and California's court system for the collection of its debts claim that it receives no benefits from the State of California? Surely, given today's reliance on such technology, a mail-order business "enjoys the benefits of, and profits from the facilities nurtured by, the State...as fully as if it were a retail store or maintained salesmen therein," to use the words of Mr. Justice Fortas, taken from his dissent in the National Bellas Hess decision.

Another area of advance since 1967 that is most important to keep in mind is computer technology. Thanks to the great improvements in this area, today's mailing list broker can take credit card purchase data, match it with other available information, and, as one such broker proclaimed in Business Week, "provide names of weekend golfers who read the Bible."

That quote was from an article two years old. Just think what targetting of your State or District's consumers is possible today.

The point is that the very computer technology advances that now permit this kind of targetting — and that allow consumers to order from home via a computer telephone linkup or from a computer terminal placed in such locations as work-place cafeterias — also permit the mail-order retailer to match tax rates to zip codes using specialty software that has been available for several years now. That it can be done is evidenced by Sears and J.C. Penneys, whose physical presence in each State compels them to collect tax on their mail-order sales. All but the very smallest mail-order retailer has, and can afford, the same capability today.

In summary, 1987's technology is dramatically different from 1967's technology. Therefore, as a result:

-- Mail-order retailers have a presence in every State that is adequate to support States' authority to impose a tax requirement on such interstate sales.

-- The mail-order retailer's extensive, continuous and systematic use of this technological base (a base that is in turn supported and nurtured by the States) clearly is a benefit that permits States' to ask for the return responsibility of tax collection duties without violating the mail-order retailer's due process rights.

-- Compliance with such a duty can no longer be fairly characterized as so onerous that it would constitute an undue burden on interstate commerce.

However, there is one other consequence of the technological boom of the last two decades that is perhaps the most important of all to keep in mind, and that is the explosive growth of the direct marketing industry itself.

The Advisory Commission on Intergovernmental Relations (ACIR) issued a report entitled "State and Local Taxation of Out-of-State Mail Order Sales" in April of 1986. In that report, the Commission noted the difficulty in determining precisely how large annual sales volumes currently are. However, whether you agree with the Bureau of the Census' "very conservative" estimate

of $11.1 billion for 1982, or the industry's own figures of sales well in excess of $100 billion in 1984, or the ACIR's best estimate of $36 billion in potentially taxable mail-order sales in 1985, it is clear that there has been a tremendous surge in growth from the approximately $2.4 billion annual sales volume for national mail-order business used when the National Bellas Hess decision was written. ACIR estimates the growth since 1967 to have been faster than the GNP or total retail sales, and it is approaching 12 percent currently. Even more rapid growth is expected as technology continues to improve, the ACIR report stresses.

The point, however, is not that mail-order retailers are becoming "fat cats" who can afford to pay an additional price for their success. Nor is it that the taxes owed but not collected on such sales (estimated to average about $120 million per year in California and, according to the ACIR, about $1.5 billion annually nationwide), are sorely needed by State and local governments, who find themselves harder pressed very day to offset dwindling Federal support for essential services to their citizens -- although this is surely the case.

Rather, the point that must be stressed is that mail-order retailers are being given a multi-billion dollar advantage over local businesses in every member of this Subcommittee's Districts every year. And this subsidy is growing by leaps and bounds.

This is the reason why Congress must act. Not to penalize success, nor to fatten the coffers of State and local governments, but to permit your small business community to compete on an equal basis with out-of-state sellers.

"Fair trade" has been a familiar term in recent days in this body; that is precisely what we are urging you to provide with this legislation.

Reflect for a moment, if you would on one aspect of fairness. Mail order sellers, as I've already noted, do not collect taxes due on their sales to customers in other states. But neither do they collect taxes on those sales on behalf of the state in which they are located either. This is because the goods are considered to be in interstate commerce and therefore not constitutionally taxable by the state of origin. In essence, these companies operate tax free and collect no taxes for any state. How can this be "fair trade."

Do not think that this is a theoretical argument. Ask your own local retailers. They will tell you in no uncertain terms that members of the direct marketing industry, who are becoming their competitors in more and more areas, today enjoy a built-in "discount" which they can pass on solely on the basis of not having to collect the sales or use tax. In some cases, this artificial discount can reach as much as 8.25 percent, and averages 4.5 percent nationwide according to the ACIR.

This damages domestic retailers, both large and small, in much more than a theoretical sense. Small retailers, particularly those who sell expensive, fungible goods such as cameras, computers, electronic equipment, and jewelry are losing sales, plain and simple.

And these are sales that few small businesses can afford to lose. I say this from experience, not supposition. Before I was elected to the Board of Equalization, I started and operated my own sports equipment manufacturing company. Like many other small businessmen, I found competition very vigorous among companies similar to mine. Often, a margin of 5 or 6 percent was the difference between making it and not making it. I believe you will find that margin even smaller for many small businesses in other lines.

But don't take my word for it. While you may want to conduct your own informal survey at home to determine whether or not the sales and use taxes are competitively significant, consider the following as further proof.

First, a 1982 study by the Joint Economic Committee of Congress found that, among certain industries, State and local taxes play an important role in the business decisions about where to locate. While the study did not isolate the impact of the various taxes in question (sales, property, or income), it did say that over 85 percent of the companies surveyed ranked State and local taxes as a "significant" or "very significant" factor in making choices as to location.

I believe that this Subcommittee and the Congress as a whole have acknowledged the influence that the tax environment can have on business behavior in your consideration of legislation to encourage economic development. This has certainly been the case in California and other States' legislatures.

Then there is the extent to which domestic retailers attempt to avoid the sales tax as further evidence of the competitive significance of such payments. For example, in New York, a joint City-State audit revealed that the sales tax was being collected on less than 2 percent of jewelry and fur sales over $10,000. This can add up. For example, in January of last year, a very prominent New York City jewelry store pleaded guilty to a felony for failing to collect $1.22 million in sales tax from its customers.

This was the largest sum ever to be paid as a result of a New York criminal tax prosecution. I can report similar experiences with the jewelry trade in Los Angeles.

In short, the National Bellas Hess decision precludes a "level playing field" among domestic retailers and mail-order retailers of the same items. The decision also certainly undermines State efforts to encourage the expansion of local business activity, thereby retarding local economic development with all of the ramifications that this produces. It also most certainly denies States and local governments much-needed revenues already due and owed to them. However, the most insidious and indefensible impact of National Bellas Hess is the competitive disadvantage it creates for domestic retailers in general and small businesses in particular.

This is why H.R. 1242 is such an important and timely measure for the Subcommittee's consideration. Not only does Mr. Dorgan's bill address the underlying inequity that the 1967 decision has created, but it does so in a manner that I believe is not only constitutional but which also provides the most all-inclusive remedy, given the manner in which the States' tax laws vary.

For example, H.R. 1242, in Section 2(b), meets any legitimate due process concerns that exist in a straightforward manner. The bill does not attempt to have Congress provide an expansion of the Supreme Court's interpretation of the Fourteenth Amendment by directly challenging the National Bellas Hess ruling in this regard. Instead, H.R. 1242 works within the context of the Court's decision by providing definitions of nexus that will fit in with and satisfy that ruling's due process requirements.

In addition, H.R. 1242 provides Congress with a most responsible means of exercising its prerogatives with regard to the Commerce Claus, and in a manner that respects the need to guard against undue burdens on interstate commerce. The bill does so by establishing, in Section 2(c), a requirement that only one tax rate for each State would have to be applied by the mail-order retailer. This is an important effort on the part of Mr. Dorgan and the bill's other supporters to recognize that wherever possible, every effort should be made to keep compliance burdens at a minimum.

Furthermore, in Section 2(f), a sales threshold is provided which must be reached by a mail-order retailer before collection responsibilities would arise. The concept of a threshold, such as the $5 million in annual nationwide gross sales of tangible personal property contained in H.R. 1242,

is another important effort to keep the burden on interstate commerce to an acceptable minimum.

Finally, and all-important for States such as California, H.R. 1242 clearly and unambiguously provides that any retailer who is considered under the terms of the bill to be engaged in business in a State can be required by such State to collect both a State and local sales or use tax.

There is apparently much confusion as to the term "use tax." It is most certainly not a personal property tax. In order to better understand exactly what is a use tax, such as that which California and 12 other states impose, a little background is necessary.

In California, the sales tax was imposed on "retailers" making "sales in the State." Under this approach, the retailer, upon the sale of a product, was required to pay a tax which could be reimbursed by the purchaser. If the retailer did not collect the reimbursement, they were not excused from paying the tax, because it was due and payable from them upon the act of making the sale. In such States, then, the sales tax is a tax on the retailer for the privilege of doing business within the State, but its effect is allowed to be shifted to the customer.

Other States decided to impose the sales tax directly on the consumer. That is, the sales tax was a consumer levy, imposed on the purchaser of the product. The sales tax in these States becomes due and payable by the consumer, upon the purchase of a retailer's product and its shipment and delivery within the State. However, for ease in administration, these States (consumer-levy States) have required the retailer to collect this tax rather than require the consumer to remit directly.

While all states, whether their sales tax was on the retailer or the consumer, shared the problem of getting out-of-state retailers to collect such tax, states such as California had an additional problem. In these states which imposed the sales tax on retailers, the only taxable event (the sale by the retailer) occurred outside the state, beyond the reach of the sales tax. Immediately, domestic retailers began to lose business because purchasers bought from retailers outside the state borders in places where there was no sales tax.

In order to remove the incentive for buying tax free from retailers outside the state, and to return a competitive balance to their domestic retailers, states such as California passed a new tax which was a companion to their sales tax, with a rate similar to the sales tax. However, this new tax was imposed, not on a retailer when he sold goods, but on a consumer upon his purchase of the goods and their entry into the State. In effect, it looked just like a sales tax in those states where it was a consumer levy. However, California already had a "Sales" tax, which was incident to the sale of goods, so it called this new tax a "Use" tax since it was incident to the purchase and use of goods.

As with other states, California could now turn to retailers outside its borders and require them to collect not the California Sales tax, as was being required by consumer-levy States, but the California Use tax. Thus, equity was restored until the 1967 Supreme Court decision.

But it is not just California's own tax laws that recognize a very distinct difference between a sales and a use tax. Interestingly, while the Supreme Court consistently referred to the Illinois tax involved in National Bellas Hess as a "use tax," it was actually a consumer-levy sales tax that Illinois was requiring to be collected by out-of-state retailers who solicited orders within the State. However, in doing so the Court was not implying that a Use Tax is synonymous with a Sales Tax:

"And if the power of Illinois to impose use tax burdens upon National were upheld, the resulting impediments upon the free conduct of its interstate business would be neither imaginary nor remote. For if Illinois can impose such burdens, so can every other State, and so, indeed, can every municipality, every school district, and every other political subdivision throughout the Nation with power to impose sales and use taxes." (emphasis added)

In the footnote to this last sentence, the Court quotes a 1965 report of the House Judiciary Committee which explicitly notes that "in most States, the local sales tax is complemented by a use tax." Clearly, the Court is indicating that these were two distinct taxes as far as it was concerned, and that the distinction was important enough to footnote.

It is for this reason that California feels so strongly about the important inclusion of the term "use tax" in H.R. 1242. It is not simply a matter of buzz words. Once again, in the words of the Supreme Court in the case of McLeod v. Dilworth, 322 US 327 (1943), "A sales tax and a use tax in many instances may bring about the same result. But they are different in conception, are assessments upon different transactions, and in the interlacing of the two, legislative authorities within our federation may have to justify themselves on different constitutional grounds."

The Board cannot stress enough how strongly we are convinced that Congress therefore must be absolutely clear that both concepts (tax on the retailer; tax on the consumer) and both transactions (sale and purchase) are included in any legislation such as that now before the Subcommittee.

That is, without the term "use tax," we believe that for domestic retailers in California and 12 of her sister States (Arizona; Connecticut; Hawaii; Kentucky; Michigan; Nevada; New Mexico; North Dakota; South Carolina; South Dakota; Tennessee; and Wisconsin), the legislation before you would provide no relief from the competitive inequities to which they are subjected as a result of National Bellas Hess.

We believe that it is not the intent of this Subcommittee, nor of the supporters of remedial legislation in this area, to exclude domestic businesses in any State from the benefits of fair trade and fair play that such legislation would provide. H.R. 1242 ensures that every one who is intended to benefit does so; the bill accomplishes this in the most simple and direct manner; and it is drafted to address the widest possible range of concerns as to its constitutional implications.

It deserves your support and your expeditious approval.

CONNECTICUT RETAIL MERCHANTS ASSOCIATION
60 Washington Street
Hartford, Connecticut 06106
(203) 527-1044

May 13, 1987

TO: Chairperson Rangel and Committee Members
Sub-Committee Select Revenue Measures,
Committee on Ways and Means

FROM: Gerald M. Noonan, President, Connecticut Retail Merchants Association

RE: Legislation requiring out-of-state retailers to collect and remit sales taxes to the home states of their customers. (H.R. 1242)

We urge you to support legislation which would require out-of-state retailers to collect and remit sales taxes to the home states of their customers. Such legislation would redress a chain of disastrous consequences that has resulted from a 1967 Supreme Court decision, National Bellas Hess v. Illinois Department of Revenue, that ended the obligation of out-of-state direct marketers and border sellers to collect "use" taxes, though consumers still owe them.

The untaxed sales of the growing direct-marketing industry pose several threats. Economic studies by Michigan State professor Ronald Fisher and Indiana University professor John Mikesell have indicated that a one percent increase in the sales tax may reduce local retail sales six percent, as consumers look for ways to beat the tax. The consequent drain on state and city revenues will force sales-tax rates higher, which will drive more consumers away from community retailers to tax-free direct-market purchases. Ultimately, Americans will lose jobs because of the unfair advantage direct-marketers have over traditional, Main Street retailers. With city and state combined sales tax rates ranging up to more than eight percent, consumers have a real impetus to shop mail-order to cut their costs. National Bellas Hess is part of a cycle in which reduced sales require higher taxes, and continuing retail-sales losses cause layoffs.

Direct marketers are taking maximum advantage of their unfair tax-free status. Today, direct marketing accounts for 14 percent of the nation's retail sales, and it is expected to control 20 percent by 1990. Its growth, thanks to an unfair tax loophole, spells disaster for Main Street retailers.

Connecticut is a state which relies heavily upon the state sales tax. As a result, in-state retailers who must add the tax to their prices are put at an obvious disadvantage. The state revenue issues aside, this legislation is one of fairness in competition. It is extremely difficult for the tax collecting and tax paying business community to stand by and watch the non-collecting business community laugh and continue to enjoy its unfair advantages.

We ask you to support legislation that will correct the present situation. We need to stop the cycle of declining sales and increasing tax rates, restore fairness to competition between traditional retailers and direct marketers, and eliminate a significant threat to jobs.

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June 15, 1987

To the Select Revenue Subcommittee
House Committee on Ways and Means:

I have no vested interest in H.R. 1242 or H.R. 1891. I have no clients in the mail-order industry. And unlike so many who write in the so-called "academic" literature in this area, I have no state governments as clients.

But because I consider much of what has published in the "academic" literature on this subject to be so totally mistaken (and because I had done the work on this issue anyway as part of getting an LL.M. degree), I herewith enclose a copy of a paper I recently did. I hope you will find it useful.

Very truly yours,

William L. Cronin

William L. Cronin
Attorney at Law

ABOUT THE AUTHOR

William L. Cronin is an interdisciplinary legal and financial advisor to entrepreneurial businesses and their owners. While most of Bill's practice is in tax and related areas, he has performed other services when critically needed including computer systems implementation, personal and corporate financial planning, general business and risk management consulting, accounting and auditing, and general commercial legal work.

Bill has over 11 years of full-time academic, post-secondary training and holds six college and law school degrees. These degrees (in liberal arts, economics, accounting, finance, law and taxation) include a second law degree called an LL.M. in Taxation.

Bill is a licensed Attorney at Law and a licensed Certified Public Accountant. He is a member of the Tax Section of the American Bar Association. He is also a member of both the Tax Division and the Personal Financial Planning Division of the American Institute of Certified Public Accountants. Bill has previously worked for the Internal Revenue Service, Coopers & Lybrand (one of the large international accounting firms), and Emerson Electric Co. (a Fortune 100 company). He has been in private practice for seven years now.

THE PROPOSED FEDERAL LEGISLATION CONCERNING USE TAXES

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INTRODUCTION

In April of 1986, the state and local government tax people, most notably the National Association of Tax Administrators,[1] searching for of additional tax revenues,[2] clearly had cause for celebration.[3] By contrast the pure mail order industry, the part of the industry with few locations and with relatively little investment in retail outlets, had cause for dismay.[4] It was in that month that a report called, "State and Local Taxation Of Out-Of-State Mail Order Sales" was published by the Advisory Commission on Intergovernmental Relations.[5] That study concluded that it was appropriate to pass federal legislation to overturn the landmark Supreme Court case National Bellas Hess[6] as follows:

> ...the Commission recommends that Congress enact legislation that would negate the National Bellas Hess decision by requiring mail order vendors to collect a state's use tax on interstate sales delivered in that state, if the mail order vendor engages in regular or systematic solicitation of sales in that state through catalogs, advertising, or other means.[7]

NATIONAL BELLAS HESS

The legal reason why states cannot now require out-of-state vendors to collect the compensating use tax is that the Supreme Court case of National Bellas Hess[8] prohibits them from doing so. In National Bellas Hess, a mail order seller, National Bellas Hess, was headquartered in Kansas City, Missouri, and it was licensed to do business only in Missouri and in Delaware.[9] According to the majority opinion, its only contact with the state of Illinois was the twice yearly sending of catalogs through the U.S. Mail and the mailing of the ordered goods to Illinois residents by common carrier.[10] However, under the Illinois use tax statute at the time, this relationship, though slight, was sufficient to require the Company to collect the compensating use tax from its customers.[11] Under the statute, the Department of Revenue obtained service of process by serving the Illinois Secretary of State.[12] National Bellas Hess appealed to the U.S. Supreme Court from an affirmance by the Illinois Supreme Court of a Cook County Circuit Court decision requiring National Bellas Hess to collect the use tax.[13] In that appeal, National Bellas Hess alleged violations of both the Commerce Clause[14] and the Due Process Clause of the Fourteenth Amendment.[15] The Supreme Court found that in this context, the tests for a violation of the Commerce Clause and a violation of the Due Process Clause of the Fourteenth Amendment were virtually the same. The test recited for the Commerce Clause was the Freeman v. Hewitt[16] test: "State taxation falling on interstate commerce * * * can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys."[17] The test cited[18] for the due process clause was the Wisconsin v. J.C. Penny[19] test: "the controlling question is whether the state has given anything for which it can ask return."[20] The court decided that where the mail order seller's only contact with the state was through the U.S. Mail or common carriers, the state could not force the vendor to collect a use tax.[21]

CURRENT LEGISLATION

In the second session of the Ninty-ninth Congress, two different bills, H.R.4305[22] and H.R.5021,[23] were proposed to allow states to require sellers outside of a state to remit a tax to the state based on the sales price of personal property[24] sold to a buyer within that state. Largely because of the crowded legislative schedule of that session of Congress, both of these bills died in committee.[25] These bills were reintroduced in the first session of the One-hundreth Congress as H.R.1242,[26] hereafter called the Dorgan bill, and H.R.1891,[27] hereafter called the Brooks bill.

The New Nexus Standard

One of the key aspects of this legislation will be the issue of nexus--determining when a vendor has reached the level of relationship to the destination state[28] to cause the application of this requirement to remit a tax based on sales price to be appropriate. The current standard for nexus for such a tax, in part determined by National Bellas Hess,[29] is generally that the vendor has to have some person who represents the vendor physically present in the state.[30] By contrast, the Dorgan Bill, H.R.1242, would allow a state to require the seller to remit a tax on a mail order sale whenever the vendor rented any personal property within the state,[31] advertised using means within the state,[32] did substantial recurring mail solicitations of persons resident within the state,[33] or had a corporate affiliate[34] or franchisee[35] that did any of these. The Brooks Bill, H.R.1891, would require the remission of a tax whenever the seller does "regular or systematic solicitation in [the]

[s]tate..."[36] [Emphasis added]. "[S]oliciting of sales" is in turn defined by the Brooks bill as "making known that a kind of tangible personal property is for sale".[37] The Brooks bill would appear to be the more general approach to the problem. This approach would seem to have the advantage of covering situations not specifically listed. And, in fact, it is this bill that the Advisory Commission on Intergovernmental Relations (hereinafter called the ACIR) endorsed.[38] On the other hand, the Brooks Bill might have a disadvantage of allowing a state too much latitude in enforcing its terms.

Another matter is drafting. There is a potential issue as to whether use taxes can be covered by a bill, such as the Brooks bill, that does not actually use the term "use tax" within its phraseology. However the bill defines the phrase "sales tax" so broadly that it is more than adequate to cover taxes called "use taxes" by the states.[39] The fact that the states on occasion have been forced by the courts to call such taxes "use taxes" rather than "sales taxes" in order for the taxes to be considered constitutional is due to a problem with the Commerce Clause. As is concluded below,[40] the Congress most likely has the power to overturn Commerce Clause problems with regard to such taxes, and any requirements on states to use such language would appear to be inapplicable to the Congress. As such, the bill would appear to be effective in this regard.

By contrast, the wording of the Brooks bill concerning the kinds of solicitation[41] that are covered might allow for considerable, unnecessary litigation on the nexus issue because of the way it is drafted. Section 7, Subsection (5) of the bill defines "soliciting of sales" as "making known that a kind of property is for sale." Section 2, Subsection (2) regarding what soliciting is covered only includes "soliciting of sales in such state." It should be noted that mere verbal substitution of these two phrases gives the false impression that there is no drafting problem because taxing "making known the willingness to sell in the state" is what the legislation is intended to reach. Unfortunately, the bill puts the two above phrases in different sections of the bill. As such proper logical substitution would require that the operative language be read to mean that the bill did not tax "making it known that a kind of property is for sale" unless the "making it known" was done in the state. A good lawyer would argue that even though the coming of knowledge to the consumer may occur within the destination state, the act of making it known occurs only in the state of the seller from which the message originates. As such, this seemingly harmless matter of wording has a good chance of effectively keeping the bill from being able from fulfilling its purpose--overturning National Bellas Hess. Presumably this drafting matter will be taken care of after the hearings are held.

De Minimis Rules

Both bills place limits on application of the law to companies of a certain size. The Dorgan bill is limited to retailers whose sales nationwide in a given year are $5,000,000 or more.[42] The Brooks bill is limited to companies which have, in a given year, nationwide sales of $12,500,000 or which have $500,000 of sales in a particular state.[43] These limitations are designed to exempt "small businesses"[44] from compliance costs associated with these rules and is roughly in line with the ACIR recommendation.[45] These limits are also designed to collect most of the revenue not collected under the current legal standards without all of the additional cost to the states of having to audit lots of small returns.[46] On the other side, this feature of the proposals yielded a sharp dissent from within the ACIR. The dissenters argued that this feature of the proposal shows that the proposal is "philosophically empty" because it encourages people to "evade the tax by buying from a small mail order firm rather than a large one."[47]

Local Component of the Tax

Another big issue is the matter of the local component of the sales tax.[48] In order to ease the compliance costs of this proposal it was felt that each state should should only have one sales tax rate for the whole state.[49] In the Dorgan Bill, this is accomplished by requiring a uniform "combined rate" for each state.[50] This would apparently allow the state to pick some kind of weighted average local sales tax component to add to the state wide rate to make the total a uniform amount for interstate sales. So in some cases the use tax rate would be greater and in other cases it would be less than the general sales tax rate in the locality of actual destination. The Brooks Bill would just relieve sellers from collecting any amounts relating to non-uniform rates.[51] This would always make the mail order rate less than or equal to the general rate locally. Still another matter is how to get any local tax component collected back to the localities. Both bills deny the state the

right to ask the vendors for an in-state geographical accounting.[52] As such the states would have to choose some arbitrary method of allocation back to localities or would keep the money in the state treasury. This is not likely to make local governments happy. And it was in fact the subject of still another ACIR dissent.[53]

Enforcement

Another issue is the effect that the bill would have on prior periods. Neither of the bills attempted to make specific provisions to protect taxpayers against retroactive application of the federally imposed standard as was recommended by the ACIR.[54] But the fact that this recommendation was made at all by the ACIR probably is more likely to be evidence of limited legal knowledge on the part of the ACIR, rather than a real need to limit retroactive application.[55] More sensibly, both bills do have provisions that would make sure that the state governments would not be limited in their enforcement actions with regard to past transactions that would have qualified for the state tax collection requirements under National Bellas Hess.[56] This type of provision is generally needed to make sure that companies that were supposed to collect the sales taxes in the past but did not collect them do not escape their existing legal liabilities with regard to those taxes.

Another issue is the question of reporting and enforcement. In the Borgan bill, the sellers are to report the division of their gross sales between the states to the IRS.[57] The IRS in turn is to share this information it has with the states. The power to share information is already authorized in part by the current Internal Revenue Code.[58] This interesting feature of the Borgan bill would eliminate the potential problem of having companies report different numbers to different states as well as the potential problem of having some sales not reported in any state because they are considered "nowhere sales" by the company.[59] If such a company position is justified, as it may well be because of the poor coordination of state laws, these items such as "nowhere sales" would be highlighted and companies would be less able to take inconsistent positions for different states.[60] This reporting would also have the incidental beneficial effect of helping states enforce their income tax laws and may well be socially desirable on this basis even if no other part of these bills are passed. There does not seem to be much comprehensive data that indicate the actual dollar magnitude of these enforcement problems or the degree to which they occur currently, much less data that give predictions as to how much greater the lack of compliance will be when these vendors who have little or no connection to the state are asked to comply with out-of-state laws. On the other hand, if compliance on the user side of the use tax is any indication, these provisions may be an absolute necessity.[61] The Brooks bill does not make use of the IRS power.[62] Both bills put limits on the reporting requirements that states can impose on the companies[63] in terms of reporting frequency--in general, at the discretion of the IRS for the Borgan Bill's requirement of the IRS return[64] or quarterly reporting for the state reporting in the Brooks bill.[65] As noted above with regard to local taxes, both bills prohibit states from requiring a geographical accounting.

Revenue Generated

Estimates of revenue that would be generated for the states by this bill vary from $500 million as estimated by the mail order industry to $1.5 billion as estimated by the ACIR.[66] To put these numbers in perspective, these amounts only represent from one percent to three percent of state sales tax revenues[67] and a mere fraction of one percent of total state tax revenues.[68] Moreover, these are only estimates of the gross amounts of tax collections projected, not the net amounts after collection costs and seller record keeping allowances. So while the tax these bills would generate for the states seem large as absolute amounts, the net gains to the states are just not terribly significant in terms of the overall scheme of things. This may be the reason why the Brooks bill is titled the "Equity in Interstate Competition Act of 1987" [69] in contrast to the Borgan bill which is titled the "Interstate Sales Tax Collection Act of 1987."[70]

There is obviously no revenue generated for the federal government by either of these bills. Because of this and because of the current, enormous federal deficit, it would seem to be a sensible to have the federal government charge the states for the cost of any program undertaken on their behalf. This is particularly true when one considers that many states, at least those that base their state income taxes on federal taxable income, have currently received a windfall of revenue from the changes in the definition of federal taxable income created by the federal Tax Reform Act. Without such a

charge, it is even conceivable that, depending on the level of the IRS involvement, the cost of the program to the federal government could well become greater than the revenue generated by the states. The Dorgan bill does not provide for such a cost transfer. The amount of cost to be incurred with regard to the potential IRS involvement is unclear at this point though presumably this uncertainty will be cleared up to some extent in the hearings scheduled by the House Ways and Means committee on the Dorgan bill for May 13'th.

ECONOMIC FACTS CONCERNING INTERSTATE USE TAXATION

Because these bills which are proposed do not generate significant revenues,[71] it is important to understand their economic effect to be sure that there are no disadvantages to this legislation. As a preliminary matter to this discussion it should be noted that there is no economic difference between a sales tax and a use tax as long as the are both imposed on the retail sales price and they are not additive but alternative taxes. This much is apparently even acknowledged by the ACIR.[72]

The Traditional 100 % Consumer Tax Legal Assumption

In cases concerning use taxes, the courts appear to concern themselves only with the vendor's burden of the collecting the tax. For example in General Trading Co. v. State Tax Commission of Iowa the court said, "To make the distributor [of the goods] the tax collector for the State is a familiar and sanctioned device."[73] Another example is National Bellas Hess. There the Court only dealt with a "liability upon an out-of-state seller to collect a local use tax".[74] Numerous other cases have discussed use taxes and either accepted them as proper or rejected them as improper without once considering whether or not the seller of goods which are subject to a use tax actually bears some of the burden of the tax.[75] Thus the courts appear to have assumed that there is no actual tax burden on the vendor arising from these sales.

Accepted Economic Facts Deny the 100% Consumer Tax Assumption

It is interesting to note the level of confusion of legal writers over what is and what is not disputed in the area of the economics of sales taxation. For example, at least one legal commentator has taken the fact that economists do disagree about how much of the sales tax is born by sellers to mean that economics has no significance in determining the proper outcome of legal issues.[76] What is apparently overlooked by this approach is that economists, even those who think that consumers bear most of the burden of a sales tax, agree that the seller does bear some of the burden.[77]

At the absolute extremes, markets that sellers face are either perfectly competitive or monopolistic. By analyzing both extremes and by analyzing the effect that the imposition of a use tax has in those extremes, it will become apparent that the use tax is not solely a tax on the buyer.

Analysis Under Pure Competition

When a tax is imposed, the seller would like to pass that tax along to the consumer.[78] But in the perfectly competitive market, the seller's individual pricing decision has no effect over the market price--the price that consumers, as an aggregate, are willing to pay for their goods.[79] Because the tax is an added cost to the transaction, buyers will be willing to buy less of the good if the nominal price stays the same. At the same time, the sellers will be willing to sell less if the nominal price does not stay the same. Thus, taxing the transaction causes less to be sold. And it is sold at an equilibrium price between the two extremes.[80] This decrease in price with a lesser quantity sold means that the seller will make less profits.

Analysis Under Pure Monopoly

Now in the case of a monopolistic market, the analysis is somewhat different.[81] By definition, a monopolist can set whatever price he desires. But the monopolist is also subject to the market demand. When the sales tax is imposed the profit maximizing monopolist makes the most money he can at a lesser output and a nominal price reduced by less than the tax.[82] This reduction of price and quantity, of course, also means less profits.

Analysis of In-Between Situations

The typical situation will be somewhere between these extremes, but in any event, the most profitable point for the seller will be less profitable after a sales tax than it was before. Some economists have suggested that many things can be done by the localities to encourage the sellers to pass on the tax by keeping prices the same,[83] but acknowledge that no law can force the sellers to pass along the tax.[84] And if the sellers did keep prices the same after the tax was imposed they would in fact lose more money that way than by making a reasonable price reduction.

The Seller as Taxpayer

Thus, to say that these taxes are taxes solely on the buyer ignores the economic facts. In fact, some economists have argued that all of a sales tax is entirely borne by the factors of production rather than by consumers.[85] And, oddly enough, one legal scholar who supports the proposed legislation, admits that there is no way to control the actual incidence of the sales tax.[86] Still another economist, one who thinks that most of the burden is on the consumer, has gone so far as to say of economists generally, "...we have come a very long way from the naive view that the sales tax is a consumer-burden tax pure and simple."[87]

These accepted economic facts should have a legal effect. The Commerce Clause, in the absence of federal action, prohibits unreasonable burdening of interstate commerce.[88] And the Due Process Clause has dual requirements that for each tax that there must be a minimal connection between the state and the party taxed as well as a rational relationship between the tax and state provided benefits.[89] Lawyers may not have brought up these economic facts in the past as courts were very sensitive to the costs of collecting a use tax.[90] And this probably made a great deal of good sense as a litigation strategy given that the economics of tax incidence are not easily understood by those not grounded in public finance microeconomics. But now that some legal commentators are trying to minimize the significance of the collection burden in terms of these tests,[91] lawyers may need to begin bringing up the fact that the burden of sales taxes is paid for in part by the seller as added proof of an improper imposition by state governments. Lawyers will also need these facts to make the proper Due Process arguments.[92] And now that the Congress is considering proposed legislation such as that discussed herein, lawyers previously not grounded in economics, who lobby as part of their legal duties, may have little choice but to learn about this branch of economics.

LEGAL STANDARDS AND VALUES

In making a social assessment of the desirability of legislatively overturning National Bellas Hess, or any case for that matter, it may be helpful to keep in mind the social values expressed by the courts in that case. It may also be helpful to see how that case fits in with the rest of the law in that area. In this latter regard, it must be admitted that many of the finer points of the case law in the area of state and local taxes cannot be reconciled as consistent with one another.[93] In part this confusion would appear to be a result of the tension between the desire to look through the legal formalisms that are present in these situations on the one hand and the desire on the part of courts to give great deference to the formalisms created by state governments as part of their legislative rights on the other hand.

Economic-Fact Standard

In many cases, the courts will look through the legal forms attending a transaction even when those legal forms may have some very important independent legal significance. Some cases disregard legal formalisms that are created by the state statutes. In the case of Wisconsin v. J.C. Penny,[94] the court said:

> A tax is an exaction. Ascertainment of the scope of the exaction--what is included in it--is for the state court. But the descriptive pigeon-hole into which a state court puts a tax is of no moment in determining the constitutional significance of the exaction. ... Such has been the repeated import of the cases.[95]

And other cases have disregarded the legal forms of rights and duties created by the common law. In Scripto, Inc. v. Carson[96] the court said:

> True, the "salesmen" are not regular employees of appellant devoting full time to its service, but we conclude that such a fine distinction is without constitutional significance. The formal shift in the contractual tagging of the salesman as "independent" neither results in changing his local function of solicitation nor bears upon its effectiveness in securing a substantial flow of goods into Florida. ... To permit such formal "contractual shifts" to make a constitutional difference would open the gates to a stampede of tax avoidance.[97]

Deference-to-the-States Standard

On the other hand, in other cases, notably where the formalism of the state's statute would mitigate in favor of upholding a tax, the courts have held that the formalities will control the result. This appears to be a matter of deference to the states to be applied when the tax statute in question appears to create a nondiscriminatory tax on the face of it. For example, the Court in Henneford v. Silas Mason[98] upheld the imposition of the use tax saying:

> Finally, there is argument that the tax now in question, though in form upon the use, was in fact upon the foreign sale, and not upon the use at all, the form being a subterfuge. ... A legislature has a wide range of choice in classifying and limiting the subjects of taxation. Bell's Gap R. Co. v. Pennsylvania, 134 U.S. 232,237...Ohio Oil Co. v. Conway, 281 U.S. 146, 159.... The choice is as broad where the tax is laid upon one or a few of the attributes of ownership as when laid upon them all. Flint v. Stone Tracy Co., 220 U.S. 107, 158, 159... The Legislature might make the tax base as broad or as narrow as it pleased.[99]

This result was obtained even though the tax in question was, as a factual economic matter, actually a burden on the sale of the goods traveling between states.[100] But in any event, it appears from the language quoted above that the majority was not primarily concerned with the economics, but with the right of the state to tax.[101]

This concern with upholding the right of the states to tax was later shown in the right of the state to force a vendor who had little contact with the state to collect a use tax. In General Trading Co. v. State Tax Commission of Iowa[102] this deference to taxing power required the payment of a use tax to the state even though the salesmen of the company were not resident in the state but merely traveled across the state soliciting orders. In Scripto[103] the deference was extended to cover independent contractors who solicited sales. In National Geographic Society v. California Board of Equalization[104] the deference was extended to cover cases in which the vendor's contact with the state had nothing to do with the sales which were taxed.

This matter of giving weight to the language of the statute, even when the language of the statute does not comport with the realities of incidence, is very real. Those who use it have even have a name for it--"legal incidence". And interestingly enough this gap between "legal incidence" and reality has been openly acknowledged by at least two of the prime supporters of the legislation now under review.[105] Truly the fact that the difference between a use tax and a sales tax is one of mere semantics is proven by the fact that the Brooks bill does not have to refer once to a tax on "use" in order to cover it completely.[106]

The Tension Between the Two Approaches

On the other hand, this deference to the right of the states to tax has been limited in two ways. First it has been limited to those taxes in which on the face of the language used by them, they were not intended to be imposed on an impermissible object. In McLeod v. J.E. Dilworth,[107] the court struck down a tax because it was levied on the "sale" by an out-of-state vendor, even though the court virtually acknowledged that a tax on "use" on in-state purchasers with exactly the same results in reality, would have been upheld.[108] Similarly, in U.S. v. State Tax Commission of Mississippi[109] the Court overturned a sales tax on liquor because the statute said that it was intended to be imposed on the federal government as represented by military purchasers.[110]

How National Bellas Hess Fits In

The second situation in which this deference to state statutes was limited was in the case where the state statute said that a seller was engaged in business in the state, but the facts appeared to be otherwise to the Court. In Miller Brothers v. Maryland[111] the state statute struck down said that any vendor who delivered into the state was engaged in business in the state.[112] In National Bellas Hess[113] the state statute struck down said that a retailer was maintaining a place of business in the state if they solicited orders by catalogs.[114]

So while the Court would not overturn a statute on account of the facts of the incidence of the tax being different than what the state statute said it was, the law has arrived at a result which at least gives some minimal protection to those with little or no connection to the state. The law will not allow the statute to say it taxes an impermissible party. And the law will ignore the statute when it appears too far wrong on the issue of presence in the state. This is of course a results analysis and not an analysis that reconciles the verbiage in the cases. But there apparently is no way to reconcile the words used.[115] So recognizing the social purposes served would appear to be as good as can be done.

THE COMMERCE CLAUSE

In National Bellas Hess, the majority of the court found that the sales transactions in question were almost exclusively interstate in character.[116] In so finding, it found that the state could not be allowed to impose a use

tax collection duty on the seller because doing so would burden interstate commerce.[117] The requirement imposed by the Court, that states not burden the seller in an interstate sale, relies on what has been traditionally called dormant Commerce Clause[118] analysis--what the Commerce Clause of the U.S. Constitution may be considered to command in the absence of any legislation by Congress.[119] In understanding the effect of federal legislation in this area, it is important to understand the reasons why the Court came to these conclusions.

History

Dormant Commerce Clause analysis was first applied to state taxation in State Freight Tax[120] in 1872. In that and other early cases, the court applied a test of whether the tax was imposed directly on the privilege of doing an interstate business.[121] If it was, then the tax could not be allowed because that would be a regulation of interstate commerce not allowed to the states.[122] This theme in the application of the Commerce Clause to state taxation was replaced, after some bit of vacillation,[123] by the theory that the Commerce Clause only prohibited multiple taxation of the interstate businesses not necessarily any burden on the interstate commerce.[124] This later theme has most recently been cast in terms of whether "the State has provided benefits and protections for those activities for which it is justified in asking a fair and reasonable return."[125]

National Bellas Hess

Interestingly enough, the National Bellas Hess court cited cases in both historical theme groups above for the proposition that the Illinois law failed the Commerce Clause test saying that "the state exaction [was] such as to invade the exclusive authority of Congress to regulate trade between the states"[126] The Court quoted Freeman v. Hewitt[127] a case in the direct-effect-on-commerce group of cases, as principal authority, saying that:

> [T]he court has held that "state taxation falling on interstate commerce * * * can only be justified as designed to make such commerce bear a fair share of the cost of the local government whose protection it enjoys."[128]

But the court also cited Northwestern States Portland Cement Co. v. State of Minnesota[129], a case in the other group for this same proposition. That case allowed the imposition of a net income tax if it was "properly apportioned to local activities within the taxing State forming sufficient nexus to support the same."[130] So under either theory, the tax had to be related to activities performed by the taxpayer within the state. To the extent that there were no such activities, the National Bellas Hess court found that the collection duty was an impermissible burden on commerce that was interstate and not local.[131]

Before repealing National Bellas Hess, it would seem appropriate to consider the Commerce Clause concerns of that case to see if they still have value. Traditionally the reason given for the dormant Commerce Clause analysis was to assure that interstate trade was free from protectionism by states.[132] As noted above, there are basically two factors of Commerce Clause analysis in National Bellas Hess. There must be a burden and it must be imposed on interstate commerce. By examining how the Court specifically addressed these two elements in National Bellas Hess more may be learned about what values the case may still have.

Interstate Transactions

There is, of course, no such thing as a purely interstate sale as all sales touch or affect at the least buyer and the seller and thus the states on both ends of the sale-purchase transaction. Similarly, with regard to the mail order solicitations, it must be admitted that there is no such thing as a purely interstate solicitation. It is undeniable, for example, that the states help to maintain the roads that the U.S. Postal Service uses to deliver the mail, that the states police the roads which are used by the Postal Service to deliver the packages, and that the states similarly provide for and protect common carriers.

As such, in tax cases, the courts apply the phrase "interstate commerce" as a technical term of art, not as plain language. The National Bellas Hess Court recognizes that the characterization of an activity as interstate was a relative characterization when it said of those mail order sales, "Indeed, it is difficult to conceive of commercial transactions more exclusively interstate in character than the mail order transactions here involved."[133] There would have been no use for the comparative "more" if there were a bright line across which sales would actually be one hundred percent non-local. And the dissenting opinion pointed out that there was a connection between the

seller and the state, namely that the seller regularly and systematically exploited the market of that state.[134] The dissent also presumed that National Bellas Hess made use of the credit facilities of the state.[135] Thus the concern of the majority cannot be said focused on the complete absence of any kind of economic relation between the seller and the state.

Instead the majority appears to focus on the fact that there is no direct economic relationship between the state and the seller. The Court phrased this test by saying that where there is "a seller whose only connection with customers in the State is by common carrier or the United States mail"[136] that connection is not sufficient to justify allowing a state to burden that seller. This theoretic of requiring a direct relationship is seen pretty clearly by contrasting the majority view with the minority one. The minority notes that there is an active solicitation.[137] But this is is an indirect relationship--a common carrier or the Postal Service who is in the state being paid to deliver free catalogs for National Bellas Hess which is not in the state. The majority explicitly contrasted this situation with the case of Scripto v. Carson:

> In that case the seller had "10 wholesalers, jobbers, or 'salesmen' conducting continuous local solicitation in Florida and forwarding the resulting orders from that State to Atlanta for shipment of the ordered goods."[138]

This latter use of so-called independent persons was seen as a presence by the company, but not the use of interstate means of delivery of goods or catalogs. Trying to find another connection, the minority noted that the Company gains profits from sales to consumers in Illinois who "might [otherwise] buy locally."[139] But this also is an indirect relationship--a consumer in the state decides not to buy locally but to buy from National Bellas Hess who is not in the state. The only direct relationship with the state is between the consumer and the state.[140] Trying to find still another connection, the minority surmises that National Bellas Hess must have used the credit facilities of the state. But in fact the minority still only found indirect relationships. The "credit resources of residents,"[141] "credit information and collection agencies,"[142] and "assign[ment] of accounts"[143] are all additional examples of relationships with at least one independent party between the seller and the state.

Burden

The majority of the Court focused on the effect that the collection duty would have on the free conduct of an interstate business.[144] The case recites the problem of the many variations of the sales and compensating use tax as an instance of excessive entanglements of an interstate business with local jurisdictions.[145] The case says that the very purpose of the Commerce Clause was to prohibit these kinds of local entanglements.[146] The Court's concern on the burden side of the issue thus appears to have been limited to the matter of the administrative burden caused by the use tax.[147] It did not appear to try to actually measure costs. It only made the determination that the regulations would cause excessive entanglements with local jurisdictions.[148]

By contrast, the National Bellas Hess dissent argued that the burden was not near as great as the majority made it seem saying that the majority "vastly underestimate[d] the skill of contemporary man and his machines."[149] In a sense this comment by the dissent may be more true today that it was when the statement was made. Some current commentary suggests that costs would be much less today than it was at the time of the case.[150] One attorney has said that computer systems could be used by the larger firms that the proposed legislation would make into tax collectors:

> At $5,000 per software package and a monthly maintenance agreement, which would cost a minimum of several hundred dollars a year, programs in this price range would be prohibitive, I believe, for a vendor whose annual gross sales were less than $500,000 a year.[151]

And the president of a computer software company that sells computer software designed to take care of the record keeping requirements for nationwide use tax compliance has said:

> Although it seems clear that the sales tax rate file eliminates much of the compliance burden of the multistate vendor, many are concerned that computer solutions are cost prohibitive. This concern is unfounded; the price of subscribing to a sales tax maintenance service for a year is less than one third of the annual salary of a clerical office worker. Furthermore, the computer processing costs to access the file and to perform the computations are very small, even for high transaction businesses.[152]

On the other hand, even if one accepts as true the suggestion that the use of computers will make the collection costs much more reasonable than they were at the time of National Bellas Hess, the actual data that has been collected on this question of costs does not particularly agree with the comments about minimal costs made above. According to the ACIR, the actual costs of collecting sales taxes by was found by a 1982 Peat, Marwick, Mitchell, and Company study as being between 2.03% and 3.75% of the taxes collected for non-mail order vendors in seven states.[153] The ACIR study also indicates that these Peat Marwick results from .083% to .19% of gross are comparable to the results of the Willis Report.[154] On the other hand, the ACIR study also correctly cites the Willis Report[155] results for costs as ranging from "negligible up to 2% of gross receipts for the interstate firms."[156] So if the same relationship would hold between the non-mail order firms and the interstate firms as existed in the Willis Report, then the amount of collection costs for the interstate firms as compared to the in-state firms would be over 10 times as much as the non-mail order firms--2% of gross for the interstate firms as compared to .19% of gross for the in-state firms. In other words, the costs of collecting the tax by the interstate firms might be as much as 39% of the tax collected for some retailers if the relationships of the Willis report held.

And even if, for some reason not noted in the ACIR report, these relationships in the Willis report that the ACIR report cites as authoritative do not apply, the current costs of the systems used in actual practice do not appear to be "very small" as the seller of computer software noted above claims.[157] Assuming that the local sales tax collection costs of local retailers cited by the ACIR[158] applied to interstate mail-order sellers, the cost for the collection systems for retailers affected by this bill would still appear to be about $25,000 ($12,500,000 *.002 of gross receipts). While these costs may be very small in relationship to the amount of gross revenue of the company, the real question is how small are they in relationship to the value of government services provided by the state.

Moreover, this whole discussion of costs overlooks the fact that the biggest part of the real costs may be considerably more significant than the mere costs of collection. As noted above, the seller does in fact bear a part of the burden of the tax itself whether the law takes this burden into account or not.[159]

The Logic Problem

Though the thought behind this kind of dormant Commerce Clause analysis is of very long standing[160] and is a well accepted part of our law[161], it must be noted that it is a bit weak in logic.[162] The theory is that because the Commerce Clause says that Congress shall have the power to regulate interstate commerce, it implies by that statement that a state shall not have the power to regulate or burden that trade.[163] The critical weak point in logic is that a negation of state's power is implied from silence.[164] Because nothing in the actual words of the Commerce Clause prohibits the states from imposing the requirement to collect a tax, it may well be that the Congress may authorize the states to do what a dormant Commerce Clause analysis would not allow.[165]

THE DUE PROCESS CLAUSE

The National Bellas Hess majority rested its decision, not only on the Commerce Clause, but also on the Due Process Clause of the Fourteenth Amendment.[166]

History

One has quite a path to follow to derive the true meaning of due process in tax cases from the law.[167] Due process cases in state taxation, as of this date, have come to be seen as derived from the Fourteenth Amendment.[168] And it is certainly true that the Fourteenth Amendment commands that "No state shall ... deprive any person of ... property, without due process of law ...."[169] But due process issues cropped up to invalidate certain state taxes even before the passage of the Fourteenth Amendment.[170] Specifically, fourteen years before the Fourteenth Amendment and its due process clause, the Supreme Court invalidated an extraterritorial tax on the ground of lack of jurisdiction.[171] Even after the Fourteenth Amendment, the cases were based on "situs" or "jurisdiction".[172] In 1903, in Louisville & J. Ferry Co. v. Kentucky,[173] some thirty-five years after the Fourteenth Amendment, the court first announced[174] that the due process clause of the Fourteenth Amendment forbade extraterritorial taxation.[175] The concept of the due process clause prohibiting double taxation arose, somewhat later, in 1930 in the case of Farmer's Loan & Trust Co. v. Minnesota[176] and has since been rejected in 1939 in the case of Graves v. Elliot[177] A year later in the 1940 case of

Wisconsin v. J.C. Penny[178] the due process test for taxation was explained as follows: [the] "simple but controlling question is whether the state has given anything for which it can ask return."[179]

The Government Benefits Test

It is this turn of phrase, later quoted by the National Bellas Hess court, which is the standard for whether a state tax can pass constitutional muster under the Due Process Clause.[180] Of course, in Wisconsin v. J.C. Penny[181] the question presented was different than that in National Bellas Hess.[182] In Wisconsin v. J.C. Penny,[183] the specific question presented was whether dividends paid from outside of Wisconsin could be taxed if they were paid to J.C. Penny shareholders, some of whom were outside of the state. The amount taxed was based on the proportion of the corporation's net income that came from Wisconsin in the year prior to the year of payment of the dividend.[184] Justice Frankfurter, writing for the majority, found that the tax was essentially a tax on the income derived from Wisconsin, that the only difference between this tax on dividends and the typical net income tax was the timing of the tax. He argued that because the dividends came from Wisconsin earnings, the dividends were properly considered to be connected to the state.[185] In the terms of his due process analysis, because the government of Wisconsin granted the benefits of government to the corporation as it earned the net income, the dividends derived from that net income were properly taxable in Wisconsin.[186] Thus, this standard was derived in a case that held a tax to be constitutional and not violative of due process.

The National Bellas Hess Majority's Approach

By contrast, Justice Stewart, writing in National Bellas Hess[187], used this same standard and found that the Illinois tax in National Bellas Hess violated due process.[188] In doing so, he borrowed language from Nelson v. Sears Roebuck,[189] which also applied Wisconsin v. J.C. Penny, as his rationale in National Bellas Hess:

> But the Court has never held that a State may impose the duty of use tax collection and payment upon a seller whose only connection with customers in the state is by common carrier or the United States mail. Indeed, in the Sears Roebuck case the Court sharply differentiated such a situation from one where the seller had local retail outlets, pointing out that "those other concerns * * * are not receiving benefits from [the state] for which it has the power to exact a price."[190]

So the test for nexus, a due process standard, is "whether the state has given anything for which it can ask a return."[191] If the state has given nothing to the vendor in the way of governmental benefits, it simply is a violation of our constitutional standards of fairness, also known as due process, for the state to be allowed either to tax the vendor or require the vendor to collect a tax for the state.

The National Bellas Hess Dissent's Approach

One commentator has commented favorably on the National Bellas Hess dissent on this issue as follows:

> ...the tax must be fairly related to the services provided by the taxing state. With that observation in mind, one may analyze properly the Bellas Hess dissent. The dissenters believed that the out-of-state seller in Bellas Hess derived benefits through large-scale, systematic, continuous solicitation and exploitation of the taxing state's consumer markets. In the view of the Bellas Hess dissent that activity constituted a sufficient connection between Bellas Hess and the taxing state to require Bellas Hess to collect the tax from the customers in the taxing state. Bellas Hess' use of the taxing state's residents' credit resources, which are dependent upon the taxing state's banking and credit institutions, further strengthened the out-of-state seller's connection with the taxing state. According to the Bellas Hess dissent, that out-of-state seller could not carry on its business in the taxing state, and particularly its substantial credit business, without utilizing the taxing state's banking and credit facilities. Moreover, the dissent thought it reasonable to assume that Bellas Hess would take measures to collect its delinquent accounts in the taxing state by using the state's facilities, perhaps including the courts.[192]

In National Bellas Hess there was no question but that National Bellas Hess "derived benefits through large-scale, systematic, continuous solicitation and exploitation of the taxing state's consumer market."[193] But the relevant question, that seems to eluded the National Bellas Hess minority[194] and,

apparently this commentator[195] is, "Where did these benefits come from ?" The answer is simple. The benefits came from the citizens of the state. Perhaps more relevant to the nexus issue though is, "Where did these benefits not come from ?" This answer is also simple. The benefits did not come from the state government. The state provided nothing in the way of governmental benefits to National Bellas Hess. The state had nothing to do with the private benefits National Bellas Hess derived from the state's citizen customers. Hence there was no nexus for the use tax.

The minority's point about using the court system is not well taken. The minority itself noted that National Bellas Hess stated that it had "brought no suits."[196] As admitted by the minority every point made in the National Bellas Hess dissent about use of the credit system or about local activities to collect accounts is based purely on conjecture and supposition.[197] As to account collection, if there were local collection activities of National Bellas Hess, clearly not facts in evidence,[198] then the Illinois Supreme Court would not have said that National "... does not have in Illinois any agent ... to accept payment ...."[199]

The use-of-the-credit-system argument is more complex, but also wrong. The minority claimed that National Bellas Hess made use of "the credit resources of residents of Illinois, dependent as that mechanism is upon the State's banking and credit institutions."[200] What this appears to really refer to is that some Illinois residents themselves borrowed money to buy from National Bellas Hess. The argument proves nothing. Or, perhaps, it proves too much. The complete argument if made explicitly would apparently have to be stated as follows:

1. National Bellas Hess is connected to the the Illinois resident by a purchase relationship;
2. The customer is connected to the banks in Illinois by the loan relationship; and
3. The banks are connected to the state by the regulatory relationship.
4. Therefore, the state benefits National Bellas Hess.

The long chain of relationships required to make the argument at all is itself proof that there is no direct relationship between the state of Illinois (and its government benefits) and the business National Bellas Hess. And to argue that the indirect relationship ought to be enough would prove too much. One can always find an indirect relationship if one looks far enough. And if an indirect relationship is enough, a company would not even need to sell goods to Illinois customers to be subject to a tax collection duty. That result would not make sense. Because the argument that an indirect benefit should be sufficient leads to this absurd result, it would seem to make sense to examine the real perceived problem rather than just the proposed solution to see if the problem is being adequately defined.

The Item Taxed Nowhere Problem

The primary rationale of the Brooks bill, called the "Equity In Interstate Competition Act of 1987," is apparently fairness. As noted above, the current statutory and constitutional law of sales taxation inherently means that all of the out-of-state sales of a mail order seller not connected with any other state are not taxed with a sales tax or a use tax. Judging from the fact that this legislation has gotten this far with so little revenue at state, it would appear that this situation apparently offends many people's sense of equal treatment. Therefore let us momentarily assume for the sake of analysis that equalizing sales taxes on all sales transactions is a desirable goal.

Looked at this way, the problem may well turn out to be not that the destination state cannot tax the sale but rather that the state of origin does not. It may be that the "unfairness" arises, in effect, from the fact that the origin state subsidizes all of the sales going out of the state relative to those staying in the state by not charging a sales tax. That this is more likely to be the true problem may be seen if one concentrates on which state, the destination or the origin state, ought to have a greater right to tax the transaction in question. In a mail-order sale, the destination state does nothing other than letting common carriers and the U.S. Postal Service operate within its border. It has the perfect right to tax and does tax common carriers in various ways. So to the extent that the transporting of the goods into the destination state adds value to the transaction, that part of the value created is already taxed. The operation of the U.S. Postal Service in the state is not properly viewed as a burden to the state. Thus, there is no part of the producer's creation of value in the product that has anything to do with any government benefits provided to it by the destination state. By contrast, the origin state is a state where the goods may have been

manufactured, stored, financed, bought and sold. It is this origin state that has given aid to the process that created value in the goods.

Why then do states of origin generally not tax goods going out of state? It may be the influence of the National Association of Tax Administrators which has always apparently expressed a preference for destination-based sales taxes.[201] Or it may possibly be to help the merchants in the state to compete in out-of-state markets. Translated to its baser terms, perhaps states prefer stimulate their own economies at the expense of other states in effect exporting their unemployment to other states. To do this, they subsidize export sales by exempting them from sales taxes. Then other states turn around and do this same thing to them. To protect themselves from this, they must levy a protective tariff, called a use tax, to tax those out-of-state producers. It is only at this point that Due Process interferes. If states really believe that all transactions should be subject to a sales tax, then perhaps they ought to consider not exempting export sales from their own taxes. Surprisingly, one prime supporter of the current legislation has suggested this alternative as a solution.[202]

Citizen-Given Versus Government-Given Benefits

One commentator has created a purported rationale for saying that the out-of-state seller has an "economic nexus"[203] in the state of destination because the seller derives benefits from "exploitation of the consumer market."[204] But even the use of this phrase is misleading. All the seller really does is sell to individuals in the state. There is no consumer market that the state maintains in mail-order goods with the possible exception of the highly regulated insurance industry.[205] Thus this characterization confuses benefits derived from dealing with the citizens of a state with the governmental benefits and protections afforded those who come into the state. The test should not be whether the citizens of the state of destination confer any benefits on the vendor. Rather it should be whether the government does. Because the state has no right to keep people in its state from trading with outsiders and because the Constitution forbids tariffs, the state does nothing when it allows this trading to go on. In the words of the relevant test, the state confers no benefits.[206]

The Outmoded Decision Argument -- Benefits

One of the articles on due process concerns makes the general claim that National Bellas Hess is outmoded.[207] This argument takes the general form of asserting that the facts have changed since National Bellas Hess justifying a change in the law. One such claim begins by noting that the new technologies such as computerized orders and more sophisticated communications networks allow for even less physical presence than ever in the destination state.[208] With more and more sales being made this way and with the states experiencing greater and greater revenue losses, so the argument goes, it is necessary that there be no physical connection requirement to a state in order to satisfy due process.[209] But the underlying facts here would seem to cut the other way. The less the connection to the state, the less benefit to the vendor that the state confers. Thus to the extent that these newer forms of trading need less and less connection to the state in carrying on their business, the state should have less of a right to tax these transactions, not more.

Other Arguments For Overturning National Bellas Hess Rejected

There have been other arguments for overturning National Bellas Hess that focus on things other than the issue of nexus. We will take these one by one.

The Government Helplessness Argument

One commentator has indicated that he feels that due process considerations should not be considered to prohibit states from taxing mail order sales if the federal government passes this legislation. Among other things, he apparently objects to the idea that the state and federal governments together would be helpless to act unless a constitutional amendment were passed.[210] But this argument seems to ignore the very real need for the Sixteenth Amendment that was caused by the Supreme Court's decision that the income tax was a direct tax as prohibited by the constitution.[211] So this partial helplessness is not without real historic parallels.

The Not a Due Process Case Argument

One article claims that National Bellas Hess was not a due process case at all and that it is not good authority on a nexus issue.[212] It does this by claiming that there was no holding on the nexus issue and that all of the rationale is based on the Commerce Clause. Simply put, this seems to ignore an entire page of the opinion and its relationship to the paragraphs concerning due process that are quoted above.[213]

The Argument Rejecting Levels of Doing Business

Still another commentator has argued that the differences between taxing and adjudicatory jurisdiction are outmoded.[214] She denounces the "levels of doing business" distinctions traditionally made to determine what different kinds of control a state could exert over a business as being no longer applicable.[215] She argues that the "affiliating circumstances" test as laid down in Worldwide Volkswagon Corp. v. Woodson[216] is the proper test for having a taxing jurisdiction.[217] And she ends by citing the Aldens cases[218], regulatory cases, as supporting her theme when in fact they do just the opposite.

The different "levels of doing business" really just refers to the very practical solution to due process problems which solution was evolved by numerous courts over many years to the effect that due process is met at different levels of activity for different purposes.[219] It is only common sense that the concept of fairness, due process, would require that for some more burdensome or intrusive forms of out-of-state regulation there should have to be more connection between the state and the out-of-state person. Despite her analysis, these differences in due process requirements persist today. There is in the law as it exists now, for example, a great difference between the amount of contact with a state needed to give the state to protect its consumers and the amount of contact needed to tax. This much was settled in a set of appropriate examples in the mail order field, the Aldens cases.[220] These cases involved a mail order seller that did not want to have certain consumer protection legislation concerning interest rates applied to it. In each case, the courts found that the consumer protection legislation should be sustained as against a due process attack even though it would not have been sustained against such attack if it had been tax legislation. The Third Federal Circuit Court of Appeals said it this way:

> Aldens' chief reliance in its due process argument is on National Bellas Hess, Inc. v. Department of Revenue, 386 U.S. 753, 87 S.Ct. 1389, 18 L.Ed.2d 505 (1967) which held that a provision of the Illinois use tax act which imposed a duty on an out-of-state mail order seller to collect Illinois use taxes was unconstitutional. The Court treated the case as a tax case and said:
>
> > "And in determining whether a state tax falls within the confines of the Due Process Clause, the Court has said that the 'simple but controlling question is whether the state has given anything for which it can ask return.' Wisconsin v. J.C. Penny Co., 311 U.S. 435, 444 [61 S.Ct. 246, 85 L.Ed. 267]." 386 U.S. at 756, 87 S.Ct. at 1391.
>
> Tax cases of necessity come in for special due process scrutiny. No state interest rates so high in the state scale of values as the state sovereign's fisc. At the same time no extraterritorial manifestation of sovereignty, except possibly arrest, is quite so offensive to common notions of its territorial limits. Thus, extraterritorial impositions of tax collection obligations have been upheld only when it can be said that a benefit has been conferred on the tax collector by virtue of the state's sovereignty, and the tax is related to that benefit. Since the Court found no way in which Illinois as a sovereign either conferred any benefit on the mail order seller or facilitated the transaction, it declined to permit extraterritorial imposition of a collection duty. The instant case presents an entirely different issue. Pennsylvania is not attempting to export any duty toward its treasury. Aldens is obtaining money from Pennsylvania residents in whom Pennsylvania has a local sovereign protective interest. There is simply no reason why in weighing the significance of that interest for due process purposes we should impose on Pennsylvania the higher burden it would have to meet in a tax collection case.[221]

This same basic analysis was also followed vis-a-vis Aldens in the Seventh Federal Circuit Court of Appeals,[222] the Tenth Federal Circuit Court of Appeals,[223] and the Eighth Federal Circuit Court of Appeals.[224]

The assertion that the World-Wide Volkswagon v. Woodson "affiliating circumstances" test should become the test for due process in the taxing jurisdiction cases does not seem appropriate. The World-Wide Volkswagon case is in a different area of the law--an auto accident case.[225] And as noted in the Aldens cases above, a state has a greater interest in protecting its citizens than it does in placing a tax on an out-of-state vendor.[226] Thus requiring that there be mere affiliating circumstances in that kind of an

accident case makes sense. On the other hand, National Bellas Hess did have a proper interest in avoiding the expense and trouble of collecting a tax for a state which did nothing at all for National Bellas Hess.

Insurance Law Analogies

The last miscellaneous argument I will deal with is the implicit assertion made by one commentator that the insurance industry cases are appropriate to use as a guide to the proper due process standard for the general mail order business.[227] In the first place, the business of insurance is very largely a legal business. The insurance companies, even those that market their products through the mails, constantly use the courts of the destination states no matter how they solicit orders. By contrast, National Bellas Hess did not use the local courts.[228] Moreover, even in the insurance industry, the case for finding a tax on pure mail order insurers, absent other regulation or presence, is extremely weak. First it should be noted that for most insurance companies, it is their presence that gives the states the right to tax them. The general right, at a lower level of connection to the state, to regulate the insurance companies to protect consumers has been used by many states to require an in-state presence for consumer protection.[229] This in-state presence often is more than sufficient to find that a benefit has been conferred.[230] Thus states are thus allowed by due process to boot strap a tax on most insurance companies.[231] This kind of consumer legislation by states has been specifically authorized by the Congress' passage of the McCarran-Ferguson Act to specifically allow the states to regulate the industry.[232] Moreover, commentator's reasoning from these cases has flaws. One should not cite specialized industry cases on a general matter issue when the general matter cases disagree. Here she cites insurance industry cases for a general mail order issue.[233] One should not cite lower court cases as being more persuasive than Supreme court cases. Here she cites a California case which follows a Wisconsin case.[234] One should not cite earlier cases, when later cases have contrary holdings on that same issue. Here she cites two earlier cases, Ministers Life & Casualty Co. v. Haase[235] and People v. United National,[236] which are contrary to National Bellas Hess, a case that comes later.[237] Note also that Ministers is not apt.[238] In Ministers there were "group leaders" who just like the parties in Scripto[239] generated business for the company, and the court said as much in the case. These cases relating to the insurance industry are inappropriate for analogy to the normal, mail order business.

Due Process As A Constitutional Command

When Supreme Court Justices of differing political persuasions, and at different times, admit something as fact, practical lawyers should stand up and take notice. This situation is present with regard to due process analysis. The majority opinion in State Board of Insurance v. Todd Shipyards Corp.[240] written by Justice Douglas in 1962 said, "Congress, of course, does not have the final say as to what constitute due process under the Fourteenth Amendment."[241] Justice O'Connor in 1982 wrote inthe dissenting opinion in ASARCO, Inc. v. Idaho State Tax Commission[242] that, "... Congress generally cannot waive a ruling of this Court decided under the Due Process Clause"[243] This position should be taken as particularly convincing when the statement runs counter to what the writer prefers as O'Connor's comment in ASARCO did.[244]

Analysis of the Constitutional Structure

Unlike the Commerce Clause analysis above,[245] the Due Process Clause analysis proceeds not from an implication in the silence of Congress but from an overt command of the constitution itself.[246] Simply put, neither the states nor the federal government is allowed to take property away from a person without due process of law.[247] It is this distinction in origin that has lead to the questioning as to whether the Congress can validate a law that violates the Due Process Clause.[248] And it is this distinction that should make the the federal sales tax statutes proposed unconstitutional.[249] It is entirely within the realm of possibility that some people will see so great a need for this legislation that they will desire to pass a constitutional amendment to allow due process to be abrogated in the area of state taxation of origin sales.[250] There are a number of people a number of people supporting this legislation.[251] But it should be necessary to have a constitutional amendment in order to abrogate the holdings of National Bellas Hess concerning nexus,[252] in the same way that it was necessary to pass the 16th Amendment to the Constitution in order to abrogate the holding of Pollack v. Farmer's Savings and Loan.[253]

In the first place, the Due Process Clause is an absolute command--"No

state shall ... deprive any person of life, liberty, or property, without due process of law ...."[254] In this respect, the Due Process Clause is not like the the commerce clause at all.[255] Because this prohibition of state action is not implied from a power of Congress,[256] it is not subject to limitation by the will of Congress. It is interesting to note that some commentators have made much of the fact that the Fourteenth Amendment does give Congress the power to enforce its provisions.[257] However this power to enforce is not a power to deny enforcement.[258] The Fourteenth Amendment gives a right to every wronged citizen to enforce its mandate for themselves.[259] The fact is that if Congress wished to, Congress could pass a law helping to enforce the provisions of the Fourteenth Amendment.[260] But that in no way is a grant of power for Congress to try to prohibit its enforcement by citizens.[261]

There is also the question of whether or not Congress can together with the states overturn National Bellas Hess. One commentator who thinks such a joint effort would be effective writes:

> The scope of congressional power to approve "unconstitutional" state laws turns on the nature of the constitutional limitation on state power. If the limitation is inapplicable to federal power, the constitutional prohibition is one dividing power between nation and states. And, as one commentator noted many years ago, "[i]t would be a shocking thing, if state and federal governments acting together were prevented from achieving the ends desired by both, simply because of the division of power between them."[262]

Let us move step by step through this conclusion. We must agree that the power of Congress to approve laws that states could not otherwise sustain as constitutional depends on the nature of the constitutional limitation on the state that is implicated. For example, a state law that would be invalidated by dormant Commerce Clause analysis could most probably be validated by Congress giving its approval if the Commerce Clause were the only problem. So the first sentence is conditionally correct. However in this context, saying that Congress could do this itself may not be correct. There appears to have been no real consideration given by the commentators who have said this to the problems this statement would have with the Uniformity Clause.[263] In fact, on the face of that clause, it would appear that the federal government could not pass a law that taxes similar sales transactions at different rates merely because of the destination of the goods.

The second sentence is also correct if taken standing alone. However, between the second sentence and the third sentence is an equivocation of terms that, though verbally very subtle, destroys the whole argument. The key is that he uses the phrase "is a division of power between them" in the second sentence as if it were the same as the phrase "simply ... a division of power between them" [emphasis added] in the third sentence. But it is not the same at all. If a limitation on state power is absolute, as the Due Process clause itself says it is,[264] such a limitation on state power can be said to be, in a somewhat awkward sense, a division of power between the state and federal government because after all the federal government can do what the state cannot. But this fact never makes the prohibition simply a division of power. In the other words, the problem is not "simply because of a division of power between them." The problem is because of an absolute prohibition. It is no less a prohibition to the state because the federal government could do it.

O'Connor's Dictum In The Add-On Dissent

Moreover, there seems, in at least one article that favors giving the states the power to so tax, to be an attack on Justice O'Connor's dissenting opinion in Add-On.[265] This article trys to make much of the fact that the footnote is dictum.[266] Doubtless, Justice O'Connor was well aware of this. Doubtless, that is why she made it short and without the detail for which lack this commentator criticizes her. She was merely exploring in a brief fashion the possible negative aspects of the majority decision, not purporting to decide this next issue. And despite what the one sentence concurring opinion of the Chief Justice Burger said,[267] the majority opinion of the Court, made no disagreement with her point, but simply said that it was an issue on which they "express[ed] no opinion."[268] So this statement that her footnote is dictum is really is no argument at all against the dictum's conclusion. Properly, it is only a statement that, currently, this particular dictum is not binding law. But this means little. The dictum of one case often becomes the decision of another case. And dictum is very important in understanding both where the law is going and where the law should go. It is particularly meaningful if written by a Supreme Court Justice.

O'Connor's Decision In Hogan

There also seems to be another attack Justice O'Connor's dictum in ASARCO. This attack is based on the supposition that she was confused as between her Hogan decision[208] and her ASARCO dissent.[209] The argument is that her decision in Hogan that the federal government cannot validate Fourteenth Amendment violations by the states does not apply in the context of taxation because of a difference in the treatment of liberty and property interests. But in neither the Due Process Clause nor the Fourteenth Amendment generally is there any priority specified as between liberty rights and these property rights. And in fact, in Hogan a realistic appraisal might be that it was a property interest, and not a liberty interest, that was implicated. The right that Hogan had not to be forced to drive across the state to go to nursing school, though certainly important and worthy, and in no way trivial, is not all that different in kind from the economic interest that a mail order house has in avoiding taxation by states in which it has no vote and from which it derives no benefit.

CONCLUSION

This federal legislation ought not to be passed. As it is, this bill would have the Congress destroy the sensible, very minimal limits on state taxation that were laid down by the Supreme Court in the National Bellas Hess case. In doing so, it will allow states to tax a creation of economic values that occurs outside of the taxing state. The Commerce Clause of the Constitution is not an absolute legal barrier to this legislation, but the rationale underlying the Supreme Court's dormant Commerce Clause analysis is still a good reason for rejecting these proposals. Allowing one state to tax another state's citizens will move us closer to a Balkanization of the national economy. Because it was the very purpose of the Commerce Clause to avoid this evil, it would be very ironic if the power granted to Congress under the Commerce Clause is used to promote a set of sales tax tariffs between the states. Unlike the Commerce Clause, due process is an command of the Constitution which is absolute. Moreover, due process is not merely a matter of separation of powers between the state and the federal governments. It is an express reservation of rights by and for the citizens as against any overreaching on the part of any government. And at a minimum, due process would require that a state should not be allowed to tax another state's citizens for governmental benefits which it, the taxing state, has not given.

FOOTNOTES

1. State Taxation of Interstate Commerce, Report of the Special Subcommittee on State Taxation of Interstate Commerce of the Committee on the Judiciary, House of Representatives, 89th Cong., 1st Sess., June 30, 1965 (ie., the Willis Report) Volume 3, p.213-4.
2. Id.
3. Some earlier legislation was less favorable.
4. Costs are high. See fns. 155 to 159 below.
5. "The Advisory Commission on Intergovernmental Relations (ACIR) was created by the Congress in 1959 to monitor the operation of the American federal system and to recommend improvements. ACIR is a permanent national bipartisan body representing the executive and legislative branches of Federal, state, and local government and the public." Advisory Commission on Intergovernmental Relations, State and Local Taxation of Out-Of-State Mail Order Sales, April, 1986, back cover of publication.
6. National Bellas Hess v. Ill. Dep't of Revenue, 386 U.S. 753 (1967).
7. Advisory Commission on Intergovernmental Relations (ACIR), State and Local Taxation of Out-Of-State Mail Order Sales, April, 1986, p.95.
8. National Bellas Hess v. Ill. Dep't of Revenue, 386 U.S. at 758.
9. Id. at 753-4.
10. Id. at 754.
11. Id. at 755.
12. Id. at 755-6.
13. National Bellas Hess, 87 S.Ct. 1389. See the syllabus as to the procedural posture of the case.
14. U.S. Constit., Article 1, §8, Clause 3.
15. U.S. Constit., Fourteenth Amend., §1, Clause 3.
16. National Bellas Hess, 386 U.S. 754, 756.
17. Freeman v. Hewit, 329 U.S. 249.
18. Id. at 253.
19. Wisconsin v. J. C. Penny Co., 311 U.S. 435.
20. Id. at 444.
21. National Bellas Hess, 386 U.S. at 758 and 386 U.S. at 759-60.
22. Introduced 3/11/86.
23. Introduced 6/12/86.
24. Section 2 of the Dorgan Bill and Section 2 of the Brooks Bill.
25. The 1986 Tax Reform Act and the Impeachment of a federal judge were competing for the time of the committees.
26. Introduced 2/25/87.
27. Introduced 4/1/87.
28. The term, "destination state," is generally used to refer to the state to which the goods are being shipped.
29. National Bellas Hess, 386 U.S. 754.
30. Fns. 93 to 115 below.
31. Dorgan Bill, Section 2, Subsection (b)(1).
32. Id. at Subsection (b)(2).
33. Id. at Subsection (b)(3).
34. Id. at Subsection (b)(4).
35. Id. at Subsection (b)(5).
36. Brooks Bill, Section 2, Subsection (2).
37. Id. at Section 6, Subsection (5).
38. Tax Notes, July 7, 1986, p.10
39. Brooks bill, Section 7, Subsection (4).
40. See fns. 160 to 165 below.
41. Brooks bill Section 2, Subsection (2) and Section 6, Subsection (5).
42. Brooks Bill, Section 2, Subsection (2)(B).
43. The $12,500,000 figure is used by the Small Business Administration to determine if a mail order company is a small business.
44. ACIR, supra at note 2, p.15.
45. Id., at p.88-89.
46. Id., at p.16.
47. Id.
48. Dorgan Bill, Section 2, Subsection (c).
49. Brooks Bill, Section 5.
50. Dorgan Bill, Section 2, Subsection (e) and Brooks Bill, Section 4.
51. ACIR at p.20.
52. Id. at p.15.
53. Ex post facto limitations of law are generally adequate to solve the

theoretical legal problem posed by the ACIR.
56. Dorgan Bill, Section 2, Subsection (g); Brooks Bill, Section 6, Subsection (b).
57. Dorgan Bill, Section 3, Subsection (a).
58. Internal Revenue Code §6103(d); Dorgan Bill, Section 3, Subsection (b).
59. ACIR, p45, p91.
60. Id.
61. ACIR, p.2
62. Fn.75 above.
63. Dorgan Bill, Section 3, Subsection (a).
64. Id.
65. Brooks Bill, Section 5.
66. ACIR p.38.
67. ACIR p.25 (1983 numbers).
68. CCH 1986 State Tax Guide. (Used to derive revenue totals.)
69. Brooks bill, Section 1.
70. Dorgan bill, Section1.
71. Fns. 66 to 68 above.
72. ACIR p.24.
73. 322 U.S. 338.
74. 386 U.S. 757.
75. Felt & Tarrant Mfg. Co. v. Gallagher 306 U.S. 62, Nelson v. Sears Roebuck & Co. 312 U.S. 359, Nelson v. Montgomery Ward 312 U.S. 373, Scripto Inc. v. Carson 362 U.S. 207, National Geographic v. State Tax Commission, and Miller Brothers v. Maryland 347 U.S. 340
76. McCray, Commerce Clause Sanction Against Taxation on Mail Order Sales: A Re-Evaluation, 17 Urban Lawyer 529, 550.
77. Fns. 78 to 84 below.
78. Watson, Price Theory and Its Uses 286.
79. Henderson, Micro Economic Theory 125. Watson 287.
80. Henderson 125. Watson 287.
81. Watson 357.
82. Henderson 220. Watson 357.
83. Due, Sales Taxation 26-7.
84. Henderson 221. Watson 357.
85. Brown and Rolph are examples. See Morgan, Retail Sales Tax 107-113.
86. Hellerstein, State and Local Taxation 658.
87. Morgan 118.
88. 386 U.S. 754, 757.
89. ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307, 317.
90. 386 U.S. at 759-60.
91. ACIR p29.
92. Fns. 166 to 264 below.
93. Miller Brothers v. Maryland, 347 U.S. 340, 344.
94. 311 U.S. 435.
95. Id at 443.
96. 362 U.S. 207.
97. Id. at 211.
98. 300 U.S. 577.
99. Id. at 587.
100. Fns. 76 to 84 above.
101. 300 U.S. 577, 587.
102. 322 U.S. 335.
103. 362 U.S. 207.
104. 97 S.Ct. 1388.
105. Hellerstein, 553. McCray, 550.
106. H.R. 1091.
107. 322 U.S. 327.
108. Id. at 330.
109. 421 U.S. 599.
110. Id, at 606-7.
111. 347 U.S. 340.
112. Id at 347.
113. 386 U.S. 754.
114. Id. at 759.
115. Miller Brothers v. Maryland, 347 U.S. 340, 344.
116. National Bellas Hess, 386 U.S. 759.
117. Id.
118. U.S. Constitution, Art. I, §8, clause 3.

119. State Freight Tax, 82 U.S. 232 (1872).
120. Id.
121. See eg., The Delaware Railroad Tax, 85 U.S. 206, 232 (1873).
122. Id.
123. See eg., Spector Motor Service v. O'Connor, 340 U.S. 602 (1951).
124. Western Live Stock v. Bureau of Revenue, 303 U.S. 250 (1938) International Harvester Co. v. Evatt, 329 U.S. 416 (1947). Complete Auto Transit Inc. v. Brady, 430 U.S. 274.,
125. Complete Auto Transit v. Brady, 430 U.S. 274.
126. National Bellas Hess, 386 U.S. 756.
127. Freeman v. Hewitt, 329 U.S. 249, 253.
128. National Bellas Hess, 386 U.S. 756.
129. 358 U.S. 450.
130. Id. at 452.
131. National Bellas Hess, 386 U.S. 756, 759.
132. Stone, Constitutional Law 249-50.
133. National Bellas Hess, 386 U.S. 756, 759.
134. National Bellas Hess, 386 U.S. 756, 761.
135. National Bellas Hess, 386 U.S. 756, 761-2. It is not at all that clear that this was in fact true.
136. National Bellas Hess, 386 U.S. 756, 758.
137. National Bellas Hess, 386 U.S. 756, 761.
138. Scripto v. Carson, 362 U.S. 207.
139. National Bellas Hess, 386 U.S. 756, 762.
140. At least this is true unless what the minority really meant, but did not say, was that consumers in a state are the property of the state. This is not all that unlikely given the commentary from state governments.
141. National Bellas Hess, 386 U.S. 756, 762.
142. Id.
143. Id.
144. National Bellas Hess, 386 U.S. 756, 759.
145. National Bellas Hess, 386 U.S. 756, 759.
146. National Bellas Hess, 386 U.S. 756, 760.
147. Id.
148. 386 U.S. 754, 759-60.
149. National Bellas Hess, 386 U.S. 756, 766.
150. Hartman, Collection of the Use Tax on Out-of-State Mail Order Sales, 39 Vand. L. Rev. 993, 1012.
151. Id.
152. Westphal, The Computer's Role in Simplifying Compliance with State and Local Taxation, 39 Vand. L. Rev. 1097, 1102 (1986).
153. ACIR p.48.
154. 386 U.S. 754, 759-60.
155. Willis Report, Vol. 3, at p.799.
156. ACIR p.46.
157. Fn 152.
158. Fn 153.
159. Fns. 78 to 92 above.
160. See Chief Justice John Marshall writing in Gibbons v. Ogden, 22 U.S. 207.
161. Stone, Constitutional Law 139.
162. Cohen, Congressional Power to Validate Unconstitutional State Laws: A Forgotten Solution to an Old Enigma, 35 Stan. L. Rev. 387, 394-5.
163. State Freight Tax, 82 U.S. 232 (1872).
164. See eg., J. Hellerstein and Hennefeld, State Taxation in a National Economy, 54 Harv. L. Rev. 949 (1941).
165. Cohen p387.
166. 386 U.S. 754, 756, 758.
167. W. Hellerstein, State Taxation of Interstate Business and the Supreme Court, 1974 Term: Standard Pressed Steel and Colonial Pipeline, 62 Va. L. Rev. 149, 149-150.
168. The Fifth Amendment is a limitation on the power of the federal government.
169. U.S. Constit., Fourteenth Amend., Section 1.
170. See discussion by Justice Black in his separate concurrance in Central Railroad Co. v. Commonweath, 370 U.S. 607 (1962).
171. Hays v. Pacific Mail Steamship Co. 17 Howard 596.
172. Lowndes, Spurious Conception fo the Constitutional Law of Taxation, 47 Harv. L. Rev. 628, 631 footnote 9.
173. 188 U.S. 385 (1903).
174. Hellerstein, State and Local Taxation 696 at footnote 14.

175. Louisville & J. Ferry Co. v. Kentucky, 188 U.S. 385 (1903).
176. 280 U.S. 204 (1930); see also Harding, Double Taxation of Property and Income (1933) and Brown Multiple taxation by the States, 48 Harv. L. Rev. 407 (1935).
177. 307 U.S. 383 (1939).
178. 311 U.S. 435 (1940).
179. Id. at 444.
180. 386 U.S. at 756.
181. 311 U.S. 435.
182. 386 U.S. 754.
183. 311 U.S.435.
184. Id. at 448.
185. Id. at 442-3.
186 Id. at 444.
187. 386 U.S. 754.
188. Id. at 758.
189. 312 U.S. 359.
190. 386 U.S. 758.
191. 311 U.S. 444.
192. Hartman at 1005.
193. 386 U.S. 754, 761.
194. Id. at 762.
195. Hartman.
196. 386 U.S. at 762.
197. Id.
198. Id. The minority admits that it assumes these facts.
199. Id. at 754.
200. Id. at 762.
201. See McCray, at 536.
202. Id.
203. McCray, Overturning Bellas Hess: Due Process Considerations, 1985 B.Y.U. L. Rev. 265, 286.
204. Id.
205. Fns. 227 to 232 below.
206. 311 U.S. 435, 444.
207. Hartman at 1007.
208. Id.
209. Id.
210. J. Hellerstein, Significant Sales and Use Tax Developments During the Past Half Century, 39 Vand. L. Rev. 961, 992.
211. Pollack v. Farmer's Savings and Loan, 157 U.S. 429, 158 U.S. 601.
212. J. Hellerstein at 589.
213. 386 us 754, 756, 758.
214. McCray, supra at 283.
215. McCray, supra at 270.
216. 444 U.S.286.
217. McCray, supra at 281.
218. McCray, supra at 294.
219. See McCray, supra at 270 for an abbreviated explanation of the levels.
220. Alden's v. Packel, 524 F.2d 38 (3rd Cir. 1975), Alden's v. Lafollette, 552 F.2d 745 (7th Cir. 1977), Alden's v. Ryan, 571 F.2d 1159 (10th Cir. 1978), Alden's v. Miller 610 F.2d 538 (8th Cir. 1979).
221. Alden's v. Packel, 524 F.2d at 43.
222. Alden's v. Lafollette, 552 at 750-2.
223. Alden's v. Ryan, 571 F.2d 1159, 1161. It is the "subject matter and purpose of the state regulation [that] is the present day starting place for a consideration of the issues before us. ...the state interest in the cost of credit extended for goods sold to residents is sufficient to overcome due process objections."
224. Alden's v. Miller 610 F2d. 538, 539. There the court emphasis was on the greater Iowa interest in the consumer legislation, but it also in essence affirms, sub silentio, the argument to the effect that the that there was a relative lack of state interest to tax as noted in the district court opinion. Alden's v. Miller, 466 F. Supp. 379 (S.D. Iowa 1979).
225. 444 U.S. 286.
226. Fn 221 above.
227. Id.
228. 386 U.S. 762.
229. See eg. Evanston Inc. Co. Inc. v. Merlin, 598 F. Supp 1290 at 1307.
230. Id.

321. Id.
322. Id.
233. McCray, Overturning Bellas Hess at 287
234. Id.
235. 30 Misc.2d 339.
236. 66 Cal.2d 577.
237. McCray at 238.
238. 362 U.S. 207.
239. 141 N.W.2d 287, 295.
240. 370 U.S. 451.
241. Id. at 457.
242. 458 U.S. 307.
243. Id. at 349.
244. Id.
245. See footnotes 112 to 159.
246. Technically speaking, I suppose that it is the Constitution, as amended, that makes this command.
247. See the text of both due process clauses at the chapter heading above footnote 160.
248. ASARCO Inc. v. Idaho State Tax Comm'n, 458 U.S. 307 (1982).
250. As discussed below at footnotes 276 to 281, this author not only denies the need for such an amendment to the constitution, but feels that such taxation would be detrimental to the economic health of the nation.
251. See McCray discussed at footnotes 216 to 243. See Hartman at 244 to 256 and see Jerome Hellerstein at 257 to 266.
252. See more generally this whole chapter, footnotes 160 to 275.
253. Pollack v. Farmer's Savings and Loan, 157 U.S.429 (1895) and also 158 U.S. 601 (1895).
254. U.S. Constit., Fourteenth Amend., Art. 1.
255. The commerce clause says that Congress shall have a power, not that the state shall not have a power.
256. Nowhere in Section 1 of the Fourteenth Amendment does the word, "Congress" even appear.
257. J. Hellerstein at 986-992.
258. Mississippi University for Women v. Hogan, 458 U.S. 713, 731-4 (1982).
259. U.S. Constit., Fourteenth Amend., Art. 1.
260. U.S. Constit., Fourteenth Amend., Art. 5.
261. Mississippi University for Women v. Hogan, 458 U.S. 713, 731-4 (1982).
262. Cohen at 422.
263. Article I, Section 8.
264. 271. U.S. Constit., Fourteenth Amend., Art. 1.
265. J. Hellerstein at 988.
266. 102 S.Ct. 3140.
267. 458 U.S. 307, 329 at fn23.
268. 458 U.S. 718.
269. Cohen at 390.
270. U.S. Constitution, Fourteenth Amendment.

STATEMENT OF THE INSTITUTE OF ELECTRICAL AND ELECTRONICS ENGINEERS (IEEE) CONCERNING H.R. 1242 "INTERSTATE SALES TAX COLLECTION ACT OF 1987."

The Institute of Electrical and Electronics Engineers (IEEE) is the world's largest technical professional society with nearly 229,000 members in the United States.

We have been made aware of proposed legislation under H.R. 1242 which would require retailers to collect sales and use taxes on interstate sales. The proposed legislation would apparently require all organizations, regardless of where they are located, to collect sales and use taxes under varying tax rates, for every State which has a sales and use tax. There is apparently no broad provision for separation between for-profit and not-for-profit organizations, but rather it leaves to the individual states to establish whether an organization is subject to its local state laws regardless of where that particular organization is located.

The legislation would seriously impact the ability of not-for-profit organizations to meet the primary purpose for which they are established. The IEEE has its purposes clearly established in its Constitution which includes "scientific and educational activities directed towards the advancement of the theory and practice of electrical engineering, electronics, radio and the allied branches of engineering and the related arts and sciences; means to these ends include, but are not limited to, the holding of meetings for the reading and discussion of professional papers, and the publication and circulation of works of literature, science and art pertaining thereto."

The financial impact of establishing and monitoring an operation which would require us to collect sales taxes for each and every state would cost us in excess of several hundred-thousand-dollars per year. The engineering community at large relies upon the ability of the IEEE and similar organizations to provide the latest scientific and technical information. It is through such dissemination that our engineers and scientists keep abreast of the advances in their fields and thus enable our nation to maintain a competitive technical position in the world. If we are required to spend the sums involved to meet this proposed new legislation, it can only diminish our ability to disseminate technical information and thus reduce our ability to be competitive.

We appreciate the need that individual states have to increase their sources of revenue to support their activities. We further recognize that for-profit organizations have the ability of writing-off these internal expenses against other federal and state taxes. The not-for-profit community however does not have this capability and would feel 100% of the impact of this legislation. It is our sincere hope that in drafting the original bill, the designers were not made aware of this impact on the not-for-profit community and it is sincerely hoped that future modifications will indeed exempt those organizations that have obtained tax-exemption on a federal level from this legislation. This relates not only to organizations which have their exemption under section 501(c)(3), but also those which have exemption under 501(c)(5) and 501(c)(6).

/cm

This Statement is submitted by:

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Statement of David Litwin, Director of Taxation, Kansas Chamber of Commerce and Industry, on H. R. 1242.

The Kansas Chamber of Commerce and Industry advocates federal legislation to facilitate collection of state sales and use tax on interstate mail order sales. The states' inability to collect the existing tax liability on such sales is an affront to tax-paying retailers and deprives the states of needed revenue. We supported H. R. 5021 of the 99th Congress, and would do so again. Unfortunately, we cannot support H. R. 1242 in its present form.

In 1986, KCCI's Board of Directors adopted the following policy.

> "The Chamber supports the enactment of appropriate federal legislation to facilitate the collection of sales and compensating use tax arising from interstate mail order sales. Such legislation should include an exemption for small volume sellers, a single combined state and local tax rate for each state, and such other provisions as may be necessary to simplify compliance to the greatest extent possible."

H. R. 5021 addressed the problem simply and directly, requiring collection of tax if the retailer in question had national gross sales of at least $12.5 million, or .$5 million in the enforcing state, and engaged in regular solicitation in such state. It further provided that remittance of tax could not be required more than once per calendar year, and that filing of returns could not be required more than four times annually.

H. R. 1242 substitutes for this straightforward approach a complex and vaguely drafted definition of "engaged in business" in the enforcing state which seems to embrace many entities and transactions that need not be addressed in order to substantially solve the problem at hand. The dollar threshold has been dropped to a single figure of $5 million annual nationwide sales.

Moreover, the expanded but vague class of businesses subject to the bill would be required to file a potentially burdensome informational return with the Internal Revenue Service.

The bill would also permit political subdivisions to invoke its provisions, while H. R. 5021 limited such authorization to state governments. Considering that both bills would apply only where there is one combined state and local rate in effect throughout the enforcing state, and on the other hand the huge number of subdivisions that could potentially enforce the bill, this provision seems to be both superfluous and potentially oppressive.

In summary, we feel that the bill in its present form is vaguely drafted, too expansive, and potentially unfairly burdensome in operation. It is excessively slanted in favor of serving the states' revenue interests, with insufficient regard for the legitimate concerns of interstate retailers. We could, and would, support its passage only if it were amended 1) to substantially conform section 2(b) to section 2 of H. R. 5021 of the 99th Congress, and 2) to delete the language authorizing political subdivisions to enforce the bill's provisions.

STATEMENT OF THE NATIONAL ASSOCIATION OF MANUFACTURERS
ON H.R. 1242

SUBMITTED TO THE SELECT REVENUE MEASURES SUBCOMMITTEE OF
THE HOUSE WAYS AND MEANS COMMITTEE

MAY 27, 1987

NAM strongly opposes the enactment of H.R. 1242, which would authorize state and local governments to require certain out-of-state sellers to collect sales and use taxes on interstate sales and would require such sellers to file information returns with the Internal Revenue Service for the purpose of assisting states in the collection of such taxes. We believe that H.R. 1242 contains a number of serious constitutional flaws.

State taxation of interstate commercial transactions and non-resident persons is subject to federal constitutional limitations. Judicial decisions based on the Commerce Clause and on the due process guarantees of the 14th Amendment have held that state taxation falling on interstate commerce or on non-resident persons violates the federal Constitution if the object of taxation does not benefit from governmental activities of the taxing jurisdiction. Under these decisions, a vendor from out-of-state may be required to collect and remit a state's sales and/or use taxes on sales to residents of the taxing state only if the out-of-state vendor has sufficient business contacts, or nexus, with the taxing state.

The leading case on this issue is National Bellas Hess, Inc. v. Department of Revenue of the State of Illinois, 386 U.S. 753 (1967). In that case, the Supreme Court ruled that it was unconstitutional for a state to impose a duty of tax collection on an out-of-state mail order retailer that advertised in the taxing state only through mailed catalogs and circulars and delivered ordered products by common carrier. The Court held the retailer's limited business contacts were an insufficient nexus with the taxing state and that, therefore, requiring the retailer to collect the state sales/use tax was an unreasonable burden on interstate commerce in violation of the Commerce Clause.

H.R. 1242 would specifically overrule the National Bellas Hess decision in the case of direct marketers with more than $5 million in business nationwide, and in addition would require such marketers to file annual information returns with the Internal Revenue Service reporting the amount of their sales on a state-by-state basis.

The Commerce Clause as interpreted in National Bellas Hess presently precludes states from requiring sellers who lack a place of business in, or other connection to, the taxing state to collect sales or use taxes on goods delivered to residents in that state. We believe this is a sound rule of law

that should be retained. H.R. 1242 would confer taxing authority in situations where, under the judicial precedents established by the Supreme Court, the requisite business nexus would not exist. It is therefore quite likely that, if enacted, H.R. 1242 would be found to violate the Commerce Clause of the Constitution. In addition, the excessive reach which H.R. 1242 proposes to grant to state taxing authorities may also violate the Due Process protections of the Constitution's 14th Amendment.

Finally, NAM believes that H.R. 1242 would unwisely involve the IRS in collecting information wholly unrelated to the administration and enforcement of federal tax laws. Existing information-sharing procedures permit the IRS and state taxing authorities to exchange income tax information to permit each party to the exchange to enforce its own income tax laws. H.R. 1242, however, goes far beyond this by requiring the IRS to collect information which it otherwise has no use for solely so that it may be turned over to the states in connection with their sales and use tax enforcement efforts. We believe this is a highly undesirable precedent.

Federal involvement in matters relating to state taxation should follow strict and precise lines of demarcation. There is a strong federal interest, for example, in restricting the reach of state-imposed unitary taxes that include in the tax base income or assets of foreign corporations beyond the "water's edge" of the United States. The current Administration has indicated its hope that the unitary tax issue will be solved by state legislative action. They have stated, however, that if this is not achieved by appropriate state action, then the enactment of federal legislation may be necessary. The states have tended to resist bitterly any federal intrusion on the unitary tax issue, and it is somewhat unseemly that they seem so eager for federal intrusion under H.R. 1242 in order to increase their collections.

For the reasons outlined above, NAM opposes the enactment of H.R. 1242, introduced by Rep. Dorgan, as well as the somewhat similar bill, H.R. 1891, introduced by Rep. Brooks.

Respectfully submitted

Thomas J. DuBos

Tax Legislative Counsel
Mobil Corporation

Chairman
State Taxation of Interstate Commerce Subcommittee
NAM Taxation Committee

STATEMENT

OF THE

NATIONAL DECORATING PRODUCTS ASSOCIATION

IN SUPPORT OF

H.R. 1242

THE INTERSTATE SALES TAX COLLECTION ACT OF 1987

The National Decorating Products Association, which is a nationwide association of paint and wallpaper retailers representing 7,000 stores in every state, strongly supports federal legislation that would eliminate the "tax-immune" status of sales by out-of-state direct marketers. The growth of these direct marketers threatens the existence not only of the traditional decorating products store, but also Main Street retailers in nearly every industry.

H.R. 1242, The Interstate Sales Tax Collection Act of 1987, introduced by Representative Byron Dorgan (D-N.D.) would reverse National Bellas Hess v. Illinois Department of Revenue, the 20-year old Supreme Court ruling forbidding states to require out-of-state direct marketers to collect and remit sales tax on purchases by their residents.

The 1967 Supreme Court ruling in the National Bellas Hess case has led to the creation of businesses that thrive on the sales tax exemption that it created. In 1985, the Direct Marketing Association estimated that the direct marketing industry controlled 15% of retail sales. They expect that figure to reach 20% by 1990. However, with the expanding use of "800" numbers, cable television, and the personal computer as a link to direct sales, that figure may well be even higher.

The fact that Main Street paint and wallpaper retailers provide trained sales personnel, show rooms, dealer preparation, and after-sale service to consumers enables out-of-state direct marketers to prey on retailers. These marketers urge customers to shop in their neighborhood stores, write down the color and model number of an item, and then order the same merchandise from an out-of-state marketer who offers discount prices because, unlike the retailer, he is not required to collect and remit the sales tax. Even if the difference in the price is only equal to the sales tax rate of the state that the product is shipped to, the savings can be quite significant on "big ticket" items, such as paint and wallpaper.

H.R. 1242 will help the Main Street paint and wallpaper retailers to compete on a level playing field with the out-of-state direct marketers. We estimate that paint and wallpaper retailers are losing more than $1 billion in sales annually as a result of this unfair price advantage enjoyed by the direct marketers. Through no fault of his own, the Main Street paint and wallpaper retailer is quickly losing his ability to compete in the marketplace because he must collect the state sales tax while his direct marketer competitors do not.

The sales tax loop-hole created by the National Bellas Hess decision not only generates unfair competition, it also threatens state revenues. Some state officials are warning that by the year 2000, sales tax revenues could decline by as much as 25% unless mail order firms are forced to collect sales taxes. If this inequity is not resolved, cash-strapped states and cities will be required to raise their sales tax rates, which will drive even more consumers away from the community retailers to the tax-free direct marketers. This vicious cycle can only be broken when out-of-state direct marketers and Main Street businesses are competing on a level playing field.

Though we support this legislation because it would make the playing field more level for the Main Street retailer, we oppose the annual national gross sales minimum threshold of $5,000,000. Many NDPA members are small paint and wallpaper stores whose gross sales are less than $5,000,000. Nevertheless, they must collect and remit sales tax; direct marketers should be required to do no less. Accordingly, NDPA believes that all direct marketers should be required to collect and remit sales tax, regardless of their size.

The National Decorating Products Association would like to thank the members of the Select Revenue Measurers Subcommittees for addressing the issue of the unfair advantage that the out-of-state seller enjoys over the Main Street retailer. We will be pleased to respond to any requests by the Subcommittee for additional information.

STATEMENT

OF THE

NATIONAL HOME FURNISHINGS ASSOCIATION

IN SUPPORT OF

H.R. 1242

THE INTERSTATE SALES TAX COLLECTION ACT OF 1987

The National Home Furnishings Association, which is a nationwide association of furniture retailers with 3,500 members representing 13,000 stores in every state, strongly supports federal legislation that would eliminate the "tax-immune" status of sales by out-of-state direct marketers. The growth of these direct marketers threatens the existence not only of the traditional home furnishings store, but also Main Street retailers in nearly every industry.

H.R. 1242, The Interstate Sales Tax Collection Act of 1987, introduced by Representative Byron Dorgan (D-N.D.) would reverse National Bellas Hess v. Illinois Department of Revenue, the 20-year old Supreme Court ruling forbidding states to require out-of-state direct marketers to collect and remit sales tax on purchases by their residents.

The 1967 Supreme Court ruling in the National Bellas Hess case has led to the creation of businesses that thrive on the sales tax exemption that it created. In 1985, the Direct Marketing Association estimated that the direct marketing industry controlled 15% of retail sales. They expect that figure to reach 20% by 1990. However, with the expanding use of "800" numbers, cable television, and the personal computer as a link to direct sales, that figure may well be even higher.

The fact that Main Street furniture retailers provide trained sales personnel, show rooms, dealer preparation, and after-sale service to consumers enables out-of-state direct marketers to prey on retailers. These marketers urge customers to shop in their neighborhood stores, write down the color and model number of an item, and then order the same merchandise from an out-of-state marketer who offers discount prices because, unlike the retailer, he is not required to collect and remit the sales tax. Even if the difference in the price is only equal to the sales tax rate of the state that the product is shipped to, the savings can be quite significant on "big ticket" items, such as furniture.

H.R. 1242 will help the Main Street furniture retailers to compete on a level playing field with the out-of-state direct marketers. Assuming that approximately 10% of all furniture sales are made by out-of-state direct marketings, we estimate that furniture retailers are losing more than $2.5 billion in sales annually as a result of this unfair price advantage enjoyed by the direct marketers. Through no fault of his own, the Main Street furniture retailer is quickly losing his ability to compete in the marketplace because he must collect the state sales tax while his direct marketer competitors do not.

The sales tax loop-hole created by the National Bellas Hess decision not only generates unfair competition, it also threatens state revenues. If out-of-state direct marketers are selling $2.5 billion of furniture annually, and the average sales tax rate is 5%, then $125 million in sales tax revenues are not being collected and paid to the appropriate state treasuries. Some state officials are warning that by the year 2000, sales tax revenues could decline by as much as 25% unless mail order firms are forced to collect sales taxes. If this inequity is not resolved, cash-strapped states and cities will be required to raise their sales tax rates, which will drive even more consumers away from the community retailers to the tax-free direct marketers. This vicious cycle can only be broken when out-of-state direct marketers and Main Street businesses are competing on a level playing field.

Though we support this legislation because it would make the playing field more level for the Main Street retailer, we oppose the annual national gross sales minimum threshold of $5 million. Many NHFA members are small furniture stores whose gross sales are less than $5 million. Nevertheless, they must collect and remit sales tax; direct marketers should be required to do no less. Accordingly, NHFA believes that all direct marketers should be required to collect and remit sales tax, regardless of their size.

The National Home Furnishings Association would like to thank the members of the Select Revenue Measurers Subcommittees for addressing the issue of the unfair advantage that the out-of-state seller enjoys over the Main Street retailer. We will be pleased to respond to any requests by the Subcommittee for additional information.

NATIONAL PEN CORPORATION 9395 Cabot Drive, San Diego, California 92181
Phone (619) 566-7800

COMMITTEE ON
RECEIVED
MAY 27 1987
WAYS AND MEANS

May 20, 1987

Mr. Rob Leonard
Chief Counsel
Committee on Ways and Means
House of Representatives
1102 Longworth HOB
Washington, DC 20515

RE: HR1242 - Use Tax Legislation

Dear Mr. Leonard:

National Pen employs over 600 people in California. The recent proposals which would require mail order companies like ours to collect state use taxes in all states, even though we only have a presence here in California, is terribly unfair. It will place a significant burden on this company and, in fact, might well be the straw that breaks this camel's back.

Of course we collect sales tax in California, which is our obligation. We do so because of our presence here and the benefits we enjoy from the state. To be burdened with similar obligations for the other states, where we have no presence and enjoy no such benefits, is simply unconstitutional.

I understand that each state is looking for revenue wherever it can find it; however, from the studies I have seen, the estimates of such revenue are inflated, and the perceived cost to businesses like ours is minimized or considered negligible. This is not true. If this bill is passed, I believe many businesses across the country will be lost. Many companies like ours will simply not be able to function with these requirements imposed upon them.

I hope you will consider these points and oppose this legislation, and I thank you in advance for your opinions in this matter.

Sincerely,

Tom Liguori
President

TL/jlh

STATEMENT OF ABRAHAM BIDERMAN
COMMISSIONER, NEW YORK CITY DEPARTMENT OF FINANCE
TO
THE SUBCOMMITTEE ON SELECT REVENUE MEASURES
THE COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES
CONCERNING
THE COLLECTION OF LOCAL AND STATE SALES TAXES
ON INTERSTATE SALES

May 27, 1987

Thank you for the opportunity to comment on the proposed legislation to resolve the serious problems of unfair competition and tax enforcement created by the United States Supreme Court's decision in National Bellas Hess v. The Illinois Department of Revenue. For twenty years that decision has prevented the local and state governments from employing the only effective tool for collecting the sales and use taxes owed on interstate transactions: collection of the tax by the seller. The City of New York supports federal legislation to remedy the situation but we do not support the approach taken in H.R. 1242. By effectively excluding local sales taxes from the coverage of the bill, the bill will perpetuate the unfair competition and local revenue loss inherent in the current situation.

The direct marketing industry has grown rapidly and shows every indication of continued growth. The Direct Marketing Association estimates that by 1990 they will have 20 percent of the retail market. A continuing factor in this growth is the inability of local and state governments to collect taxes on mail order sales. The witness for Circuit City at the public hearing pointed out that one of the major reasons people use their telephone ordering service is to evade local and state sales taxes. Direct marketing firms already have a justifiable advantage over retail firms because of the different methods of business, but the ability of their customers to evade local and state sales taxes provides an entirely unjustified competitive advantage.

Besides the damage done to local businesses, local and state governments lose substantial revenue through this loophole. Nationally, local and state governments lose $1.5 billion each year.

There are several important points to note about the bills before Congress. First, they impose no new taxes. The sales and use taxes which would be collected under the bills are already on the books and owed. The problem is that they are uncollectible under the current system. Second, these taxes are owed by the customers, not by the direct marketers. But the direct marketers, like local retailers, are the only practical means to collect these taxes. Third, all of the bills exempt small firms from the obligation to collect the taxes. According to the Advisory Commission on Intergovernmental Relations, only approximately two to four percent of the nation's direct marketing firms will come under the various proposals. These large firms, however, account for between 70% and 75% of the dollar volume of direct marketers. Thus the legislation places a burden only on those firms best able to bear it, while still capturing the great majority of sales.

Our objection to the various proposals before the Congress, including H.R. 1242, is that they do not provide anything like a workable solution to the problem because they do not address local sales taxes. Local sales taxes are included only if they are applied at a uniform rate and base throughout a state and are administered by the state. As Congressman Dorgan admitted during the public hearing, no local sales taxes meet those requirements. New York City's sales tax is imposed at the same rate, four percent, as New York State's sales tax. Yet the City's sales tax would not be collected under the proposals. The revenue loss to the City is significant, approximately $50 million each year. The unfair advantage that direct marketing firms have over local firms would also continue.

The collection of local taxes is entirely feasible. Some firms, such as Sears and J.C. Penney's, must collect them nationwide even under the Bellas Hess decision because they have facilities nearly everywhere. Other firms, which are regional, collect them for more limited areas. Computer programs exist which provide the necessary local sales tax computation. The cost is moderate and would only be incurred by largest direct marketing firms. Firms already collecting local taxes have told us that they have few problems using the computer systems. If sales are by credit card, telephone, or COD, the tax can be computed and added to the bill. For cash sales, the customer is either billed for the difference or the merchandise is sent COD. The problems the direct marketers anticipate may well turn out to be illusory once consumers expect to pay the sales tax. As with the rest of our tax system, voluntary compliance increases once the taxpayers are accustomed to the rules.

While we support federal legislation in this area as the only way to resolve the problems created by the Bellas Hess decision, any legislation must provide for the collection of local as well as state sales taxes.

Thank you again for the opportunity to comment on the proposed legislation.

STATEMENT OF LUCAS A. POWE, JR.
BERNARD J. WARD CENTENNIAL PROFESSOR OF LAW
THE UNIVERSITY OF TEXAS

Mr. Chairman. My name is Lucas A. Powe, Jr. and I am the Bernard J. Ward Centennial Professor of Law at The University of Texas. I hold a B.A. from Yale University, my J.D. from the University of Washington, and I was Law Clerk for Justice William O. Douglas of the United States Supreme Court during the 1970 Term. Since that time I have been on the Texas faculty where my specialty is Constitutional Law. In that capacity I have testified before several committees of the House of Representatives and the Senate and written numerous articles as well as a recent book. In addition to teaching at Texas I have taught Constitutional Law as a Visiting Professor at Berkeley, Georgetown, and the University of Connecticut.

I wish to address the constitutionality of H.R. 1242 and H.R. 1891, which would authorize states to impose tax collection duties on out-of-state direct-mail retailers. National Bellas Hess v. Illinois Department of Revenue, 386 U.S. 753 (1967) and subsequent cases demand a substantial nexus between the state and its would-be tax collecting retailers. These cases make it all but certain that the two bills in question would be quickly declared unconstitutional in whole (H.R. 1891) or in part (H.R. 1242).*

National Bellas Hess was a Delaware Corporation doing interstate direct-mail business from Missouri. Illinois amended its use tax statute to require firms "soliciting orders within this State from users by means of catalogues or other

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* It is doubtful anyone would support H.R. 1242 without the unconstitutional provisions as the remaining parts are either unnecessary or tied to the unconstitutional parts.

advertising" to collect the tax on Illinois transactions. The Supreme Court held that the Illinois requirement violated both the Commerce Clause and the Due Process Clause. As to the former, the Court found Illinois had unreasonably burdened the interstate market. As to the latter, the Court held that the solicitation and subsequent delivery through interstate channels did not provide the state with a sufficient nexus to render constitutional its demand that National Bellas Hess operate as a tax collector.

There can be no doubt of the plenary power of Congress over interstate commerce. Congress can legislate to remove barriers to commerce, to create barriers to commerce, or to allow the states to create barriers to commerce. When the Court sustained the McCarran Act in Prudential Insurance v. Benjamin, 328 U.S. 408 (1946) all these issues were finally put to rest. Thus neither H.R. 1242 nor H.R. 1891 raises any questions of constitutionality under the commerce clause even though each would undo the decision in National Bellas Hess.

Congressional power is not plenary under the Fourteenth Amendment, however. Just two years ago the Supreme Court held that an Alabama tax, imposing higher burdens on out-of-state insurance companies, violated the Fourteenth Amendment despite the fact that it was duly authorized by the same McCarran Act. Metropolitan Life Ins. v. Ward, 105 S. Ct. 1606 (1985). Metropolitan Life thus requires that Congressional actions comport with Court decisions construing the Fourteenth Amendment. Neither H.R. 1242 nor H.R. 1891 could legislatively create a Due Process nexus that the Court has held does not exist. To the extent either loosens the requirements of necessary contacts between the taxing state and out-of-state direct-mail retailers, it would be unconstitutional.

In a series of state taxation of interstate commerce cases decided in the 1970s and 1980s, the Court has formulated a four-part test of constitutionality. Complete Auto Transit v. Brady, 430 U.S. 274 (1977). The first prong of the test requires a sufficient nexus between the party and the taxing

state. In Commonwealth Edison v. Montana, 453 U.S. 609, 626 (1981) the Court described the first prong of Complete Auto Transit as follows: "Under this threshold test, the interstate business must have a substantial nexus with the State before any tax may be levied upon it. See National Bellas Hess, Inc. v. Illinois Revenue Dept., 386 U.S. 753 (1967)." (Emphasis in original.) Thus the Court requires "a substantial nexus" between the enterprise and the taxing state before the state may make impositions on the enterprise. As the Complete Auto Transit line of cases demonstrates and any observer would already know, few cases present real nexus questions. But some do, and when nexus becomes the issue, National Bellas Hess is the standard. It helps demonstrate what is and what is not "a substantial nexus."

First, what is "a substantial nexus?" If the firm the state has required to collect its taxes has either agents working in the state, Felt & Tarrant v. Gallagher, 306 U.S. 62 (1939), or local retail outlets, Nelson v. Sears, Roebuck & Co., 312 U.S. 359 (1941), Nelson v. Montgomery Ward, 312 U.S. 373 (1941) the nexus is constitutionally sufficient. When the enterprise has those types of presence in the state it is necessarily receiving the benefits of state government: fire, police protection, services, opportunities. In the frequently quoted words of Wisconsin v. J.C. Penney, 311 U.S. 435, 444 (1940): "The simple but controlling question is whether the state has given anything for which it can ask return." Thus in National Geographic v. California Equalization Board, 430 U.S. 551 (1977), the issue was whether the fact that the National Geographic had two offices in the state and some local sales constitutionally justified the state's requiring it to collect taxes for its exclusively interstate mail order business. The Court held that this continuous presence by the National Geographic was a sufficient nexus to justify California's demanding that the National Geographic collect its tax.

Miller Bros. v. Maryland, 347 U.S. 340 (1954), demonstrates that the amount of "presence" is the cutting edge

of "substantial nexus." Miller Bros. operated on the Delaware side of the Maryland border. It did a substantial Maryland business and occasionally shipped goods into Maryland by its own truck. Yet even the presence in Maryland of tangible personal property in the form of the truck was held insufficient for Maryland to require it to collect its tax.

If actual "presence" may be insufficient, as Miller Bros. shows, then "no presence" will necessarily be insufficient. This, of course, is the teaching of National Bellas Hess. Without a real presence, the amount of direct mail sales is irrelevant. Note that National Bellas Hess was a very large operation. In 1961 it had sales of $60 million nationally and well over $2 million dollars in Illinois. Still Illinois could not force it to become a tax collector.

Nor did the obvious fact that a direct-mail business needs credit facilities affect the National Bellas Hess result. The dissenters (Justices Fortas, Black and Douglas) argued that beyond sales, the necessary constitutional nexus could be found in National Bellas Hess' utilization of Illinois credit facilities. Id. at 762. The majority was unmoved.

Summarizing National Bellas Hess, Miller Bros. and National Geographic, the following points stand out: (1) Some actual presence in the taxing state is not a sufficient nexus. (Miller Bros.) When the California Supreme Court concluded that "the slightest presence within such taxing state" was sufficient, the Supreme Court specificially eschewed reliance on that formulation. (National Georgraphic, 430 U.S. at 556.) (2) Very substantial direct mail sales are not sufficient. (National Bellas Hess.) (3) This is so even when the retailer utilizes the credit facilities of the taxing state. (Id.) (4) What is necessary is some actual presence beyond the interstate transaction. Without that, the Due Process Clause bars imposition of the duties of tax collection on an out-of-state company.

With these points in mind, we may now analyze H.R. 1242 and H.R. 1891. The latter is the easier to assess. Beyond

regular interstate-sales solicitation, all H.R. 1891 requires for nexus is gross receipts of either $12.5 million nationally or $500,000 within the taxing state. Even in 1961 dollars this is far less than National Bellas Hess' nexus with Illinois which was found inadequate. There simply is no argument for the Due Process nexus of H.R. 1891 except that National Bellas Hess is no longer a viable constitutional decision.

The constitutional questions are a little closer with H.R. 1242. Several of the aspects of "engaged in business" in the taxing state are constitutionally valid (or at least appear to be so), specifically, a retailer deriving rentals from the lease of tangible personal property within the state. If property were within the state on a fairly continuous basis, then the Miller Bros. bar would probably be cleared. Similarly intrastate (as opposed to interstate) advertising is likely to be a sufficient nexus. Under National Georgraphic, operation by franchisees or other similarly controlled interests are also likely to constitue a substantial nexus.

Serious constiutional problems, however, are raised by section 2(b)(3), which attempts to reach around National Bellas Hess if there are substantial sales where (1) "the retailer benefits from any banking, financing, debt collection, telecommunications or marketing activities occurring in that state" or (2) the retailer "benefits from the location in that State of authorized installation, servicing, or repair facilities." Yet §2(b)(3) in reality simply restates what National Bellas Hess found insufficient.

Retailers needed to be paid in 1967 no less than they do in 1987 and no one can dispute that credit institutions are a great help. But, as the dissenters in National BellAs Hess noted and argued, credit institutions helped National Bellas Hess. Due Process nexus requires that the state give the retailer something for which the state can demand a return. Wisconsin v. J.C. Penney.

What H.R. 1242 attempts to do is eradicate the requirement that the state provide the retailer something (police, fire

protection, the benefits of security). In its place H.R. 1242 would substitute the proposition that the state would provide something to other institutions which in turn could provide the retailer something (in this case either credit facilities or an ability to service the product after sale). The substitutionary approach of H.R. 1242 fails in three ways. First, it is inherently limitless. Taken to its logical stopping point, it would permit a state to justify its taxing out-of-state retailers on the ground that it allows its citizens to have money with which they may choose to purchase from out-of-state retailers. The Due Process nexus requires the state to provide something to the retailer before it can even ask for something in return. Second, as already noted, this very argument was raised in National Bellas Hess -- and it was rejected. Third, the Court made clear in National Geographic that it was not adopting the test of the Calfiornia court of "the slightest presence" within the state. If some actual presence is insufficient for these Due Process purposes, then the presence of others is a fortiori insufficient.

Nor would H.R. 1242 be strengthened by combining it with the sales requirements of H.R. 1891 ($12 million nationally or $500,000 locally). This combination would fall short of the very facts of National Bellas Hess -- millions of dollars of sales backed up by the credit facilities of the state of the consumers -- that the Supreme Court specificially held could not constitute an adequate constitutional nexus.

There remains the point, noted in conjunction with H.R. 1891, that someone might argue that National Bellas Hess is no longer good law. Such an argument, however, would border on the frivolous. First, National Bellas Hess is continuously cited for its Due Process test, and indeed it represents the first prong of the four-part Complete Auto Transit test that the Court has evolved to handle issues of state taxation of interestate commerce. Second, National Geographic provided an opportunity to cut back on National Bellas Hess and Miller

Bros. The Court was unanimous in National Geographic* and the facts offered an opportunity to move toward a loosening of the Due Process nexus of National Bellas Hess and especially Miller Bros. Instead the Court cited and relied on both cases. Third, 1987 seems like a very odd time for the Court to adopt a twenty year-old dissent by the only New Dealers left on that Court. Justices Black, Douglas, and Fortas are not the individuals guiding the current Supreme Court. Finally, even the National Bellas Hess dissenters assumed that the costs of tax collection by an interstate retailer are identical to those of an in-state retailer. 386 U.S. at 766. This was just an assumption as there was no evidence on the point in the record. Yet the assumption was wrong. Costs of collection by an interstate retailer are much higher than costs of collection at the cash register. Had the dissenters known this it is probable that they would have joined to make National Bellas Hess unanimous.

In any event, its result has been approvingly cited for twenty years at the Supreme Court. Legislation like H.R. 1242 and H.R. 1891 will offer false hope to states, force retailers to pay attorneys fees to litigate, and surely result in a finding of unconstitutionality. There are areas where the jurisprudence of the Supreme Court is in flux and legislation can provide a great assist. Due Process nexus is not such an area. The Court's holdings are clear and in these circumstances the oath to support the constitution requires a vote against bills that run directly counter to the Court's holdings.

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*Chief Justice Burger and Justice Rehnquist did not participate.

THE HONORABLE OLYMPIA J. SNOWE, MC

TESTIMONY FOR THE HOUSE WAYS & MEANS SUBCOMMITTEE ON SELECT REVENUE MEASURES

"THE INTERSTATE SALES TAX COLLECTION ACT OF 1987" (H.R. 1242)

Mr. Chairman, I want to thank you for providing me with an opportunity to express my views regarding H.R. 1242, legislation that would authorize State or local governments to require retailers to collect sales and use taxes on interstate sales.

I am opposed to H.R. 1242. My opposition is based on several concerns. First, I believe there are some questions about the constitutionality of this legislation. Secondly, this legislation would impose some very serious administrative burdens on many retail companies. Thirdly, it may not raise as much revenue as its supporters believe. My statement will briefly outline these concerns for the Subcommittee's consideration.

The Supreme Court, in the National Bellas Hess decision, decided that State and local governments cannot constitutionally require companies to collect and remit sales and use taxes unless the company has a sufficient business operation within the state. The required connection has been held to exist where the company arranges sales through local agents or maintains retail stores in the taxing state. If the company uses only common carriers or the United States Postal Service, then the test of a required connection within a particular state has not been satisfactorily met.

Thus, my initial concern is that H.R. 1242 would directly conflict with the Supreme Court's interpretation of the due process and commerce clauses of the Constitution, as expressed in the National Bellas Hess decision.

In addition to these constitutional concerns, there are practical problems with H.R. 1242 as well. Currently, there are 45 states that have their own sales taxes. H.R. 1242, if enacted, would require retailers to collect sales taxes in every state where they sell goods. In addition, companies would be forced to forward the taxes they collect to each state involved, keeping careful account of the amounts owed to each and every state. Retailers having extensive business in nearly every state would have to administer 45 individual and different state sales taxes.

The administrative burdens and exorbitant expenses that fulfilling the requirements of H.R. 1242 would place on many mail order firms are totally unreasonable. Many mail order firms would have to devote excessive amounts of crucial advertising space just to separately list the 45 state sales taxes, any unique exemptions to these sales taxes in the respective states and proper payment instructions for the different taxes as well.

While mail order firms would be required to take all of these steps to comply with this bill, it should be mentioned that these very same retailers derive no benefit whatsoever from the state sales taxes that they would be forced to collect.

Meanwhile, in-state retailers would derive unfair additional benefits, because they enjoy many of the direct benefits from the retail companies paying their state's sales tax, among them: any transportation improvements, employee training programs and economic development programs. Thus, for all of the effort expended by out-of-state retailers to comply with this bill's provisions, they would receive no benefit.

The last point I would like to make addresses the revenue aspects of this bill. The supporters of this legislation state that its enactment will dramatically increase revenues. However, there may be additional costs that would accompany the provisions of this bill that could possibly exceed any possible increase in revenues.

For example, the provisions of this bill could cause a considerable decline in the sales of mail order companies and other businesses having interstate sales that would be newly taxed by H.R. 1242. This would result in the loss of millions of dollars in retail sales, which could lead to the loss of thousands of permanent and temporary jobs. The simple fact is that the imposition of this type of a new tax might have the effect of hurting the overall economy. In Maine particularly, this legislation would have a severe effect on our mail order businesses, because of the loss of business revenues and possible loss of jobs would likely cost the State of Maine more money than the collection of the new State sales tax brought in.

In closing, let me reiterate that I am opposed to H.R. 1242 for three main reasons: there are some serious questions about this legislation's constitutionality, the bill's provisions would impose unreasonable administrative burdens on retailers and finally, it may not raise as much money as originally expected.

Again, let me express my appreciation to the Chairman and Subcommittee for the opportunity to express my views and concerns on H.R. 1242, as well as provide the Subcommittee with my perspective on an issue of significant importance to the economy of the State of Maine.

Thank you very much.

UNION PEN COMPANY

777 West Putnam Avenue, Greenwich, CT 06836 (203) 531-4240

May 18, 1987

Mr. Rob Leonard
Chief Counsel
Committee on Ways and Means
House of Representatives
1102 Longworth HOB
Washington, DC 20515

Re: Bill # HR 1242

Dear Chairman Rangel:

As president of Union Pen, a direct marketing company in Greenwich, Connecticut, I wish to voice my concern and opposition to proposed federal tax legislation for a bill which would require mail order companies such as ours to collect use taxes in states where we have no presence.

We currently collect Connecticut and New York state taxes. While it is a cumbersome and costly procedure, we recognize it as a necessary evil. In return, we at least benefit from those states' services. But collecting taxes for other states would not only be annoying, more difficult, extremely costly and time consuming -- it would not benefit us, our employees, or our customers in any way. It would just make the already high cost of doing business even more expensive and in the long run, could very well affect our overall contribution to the American economy.

Chairman Rangel, I urge you to do all you can to oppose any such tax legislation -- either now, or in the future.

Sincerely,

UNION PEN COMPANY

Morton Tenny
President

MT/ls